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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 10

THE UNITED STATES, PETITIONER

v.

OLYMPIC RADIO AND TELEVISION, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION FOR CERTIORARI FILED MAY 25, 1954
CERTIORARI GRANTED OCTOBER 11, 1954

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 839

THE UNITED STATES, PETITIONER

vs.

OLYMPIC RADIO AND TELEVISION, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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1 In the United States Court of Claims

No. 19–52

OLYMPIC RADIO AND TELEVISION, INC., PLAINTIFF

v.

THE UNITED STATES OF AMERICA, DEFENDANT

Petition

Filed January 14, 1952

To the Honorable, The Chief Judge and Judges of the United States Court of Claims:

The plaintiff, Olympic Radio and Television, Inc., respectfully represents and alleges:

1. The plaintiff is a corporation organized and existing under the laws of the State of New York, having its office and principal place of business at 34–01 Thirty Eighth Avenue, Long Island City, New York. During the taxable year involved plaintiff was engaged in the manufacturing of television and radio receiving sets.

2. In this suit plaintiff seeks to recover from the United States the sum of $148,841.72, being income and excess profits taxes which were erroneously and illegally assessed and collected from
2 the plaintiff by the Collector of Internal Revenue for the Second Collection District of New York for the year 1944, and which was erroneously paid by the plaintiff to the said Collector. In addition, the plaintiff seeks to recover from the United States interest on such amount from the date of such payment and collection.

3. Plaintiff's claim to recover such amount and interest is founded upon the laws of the United States and particularly upon Section 122 of the Internal Revenue Code, and upon Title 28, United States Code, Section 2516. Jurisdiction of this action is vested in the Court of Claims by Title 28, United States Code, Section 1491.

4. Plaintiff kept its books and accounts on the accrual basis and filed its Federal corporation income and declared value excess profits tax returns and excess profits tax return on the same basis using a calendar year. Said returns for the year 1944 were filed on or about March 15, 1945, with the Collector of Internal Revenue for the Second Collection District of New York.

5. Plaintiff paid its excess profits tax liability for the year 1944 to the Collector of Internal Revenue for the Second Collection District of New York on the following dates and in the following amounts:

Date of payment	*Amount of payment*
Mar. 13, 1945	$173,181.81
June 5, 1945	173,181.81
Sept. 7, 1945	138,545.45
Dec. 15, 1945	138,545.45
Total	623,454.52

3 6. Plaintiff filed its Federal corporation income tax return for the calendar year 1946 with the Collector of Internal Revenue for the Second Collection District of New York on or about March 15, 1947. Said return as filed by the plaintiff for the year 1946 disclosed no income tax liability, and reflected a net operating loss for the year 1946 of $324,844.23.

7. Upon the audit of the plaintiff's income tax return for the year 1946, the Bureau of Internal Revenue reduced the net operating loss for the year 1946 to $310,872.60 to which the plaintiff agreed.

8. During the calendar year 1946 plaintiff paid a total of $263,272.80 in excess profits taxes as follows:

Date of payment	*Amount of payment for calendar year 1945*
Mar. 14, 1946	$86,660.81
June 15, 1946	86,660.81
Sept. 12, 1946	86,660.81
Dec. 12, 1946	3,290.37
Total	263,272.80

9. On or about June 11, 1948, plaintiff filed a claim for refund on Form 843 with the Bureau of Internal Revenue, being a claim for refund of income and excess profits taxes for the year 1944 erroneously and illegally assessed and collected by the Collector of Internal Revenue for the Second Collection District of New York in the amount of $191,004.04.

10. More than six months has elapsed since the filing on or
4 about June 11, 1948, of said refund claim, above referred to, during which time the Commissioner took no action with respect to the said claim for refund.

11. The refund claim, above referred to, was based upon the application of Section 122 (d) (6) of the Internal Revenue Code. The refund claim on said Form 843 was computed by adding to the agreed net operating loss for the year 1946 the sum of excess profits taxes actually paid by the plaintiff during 1946.

12. Up until the time of the filing of this complaint, plaintiff has not received any portion of the amount claimed in said refund claim, nor has the plaintiff been credited in any manner for tax purposes or otherwise with any portion of the amount claimed in said refund claim.

13. The assessment and collection of excess profits tax for the year 1944 in the total amount of $148,841.72 was erroneous and illegal.

14. Plaintiff is the sole owner of the claim here asserted and has not made an assignment or transfer of said claim or any part thereof or interest therein.

Wherefore, the plaintiff prays, judgment for the total amount of at least $148,841.72 with interest thereon from the date of payment and such other and further relief to which it may appear the plaintiff is entitled.

EUGENE MEACHAM,
824 Connecticut Avenue NW.,
Washington 6, D. C.

5 In the United States Court of Claims

Answer

Filed May 13, 1952

The United States of America, defendant herein, by its Acting Assistant Attorney General, hereby makes answer to plaintiff's petition as follows:

1. Admits the allegations of paragraph 1.

2. Denies that the income taxes sought to be recovered in this suit were erroneously and illegally assessed and collected from the plaintiff or were erroneously paid by the plaintiff to the Collector of Internal Revenue, and admits the remaining allegations of paragraph 2.

3. Admits the allegations of paragraph 3.

4. Admits the allegations of paragraph 4.

6 5. Admits that plaintiff paid its excess profits tax liability for the year 1944 in the amounts set forth in paragraph 5 and that such amounts were paid on approximately the dates set forth therein.

6. Admits the allegations of paragraph 6.

7. Admits the allegations of paragraph 7.

8. Admits the allegations of paragraph 8.

9. Admits that on or about June 11, 1948, plaintiff filed a claim for refund of income and excess profits taxes for the year 1944,

but denies that such taxes were erroneously and illegally assessed and collected or that plaintiff is entitled to recover on any of the grounds set forth in said claim.

10. Admits the allegations of paragraph 10.

11. Admits that the refund claim was based upon the application of Section 122 (d) (6) of the Internal Revenue Code, but alleges that it is without knowledge or information sufficient to form a belief as to the truth of the remaining averments of paragraph 11.

12. Admits the allegations of paragraph 12.

13. Denies the allegations of paragraph 13.

14. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the averments of paragraph 13.

7 Wherefore, defendant prays that plaintiff take nothing from it in this suit and that the same be dismissed.

ELLIS N. SLACK,
Acting Assistant Attorney General.

ELIZABETH B. DAVIS,
Attorney.

8 In the United States Court of Claims

Plaintiff's motion for summary judgment together with supporting affidavit, and exhibit thereto

Filed July 16, 1952

Comes now the plaintiff, Olympic Radio and Television, Inc., and respectfully moves this Honorable Court to enter a summary judgment herein and as grounds thereof refers to the pleadings heretofore filed herein and the accompanying affidavit, all of which are made a part hereof by this reference, which disclose that there is no genuine issue as to any material fact and that the plaintiff is entitled to judgment as a matter of law, pursuant to Rule 51 (a) of the Rules of the United States Court of Claims (revised May 15, 1951).

(S) Eugene Meacham,
EUGENE MEACHAM,
Attorney of Record,
824 Connecticut Avenue NW.,
Washington 6, D. C.

10 *Affidavit in support of motion*

STATE OF NEW YORK,
County of Queens, ss:

Morris Sobin, being duly sworn, deposes and says: that he is Vice President and Treasurer of the Plaintiff above-named in this proceeding; that he was the Treasurer of the Plaintiff during the calendar year 1944 and up to the present time; that on or about June 11, 1948, Plaintiff filed a claim for refund of income and excess profits taxes for the year 1944; that said refund claim was based upon the carry-back of a net operating loss of the Plaintiff from the year 1946 to the year 1944, as computed under the provisions of Section 122 (d) (6) of the Internal Revenue Code; that said refund claim referred to adjustments under Section 122 (d) (6) for amounts representing excess profits taxes paid or accrued during 1946; that in this proceeding the Plaintiff has abandoned its contention with respect to excess profits taxes accrued in the year 1946 in the sum of $86,333.74 and relies solely upon the payment of excess profits taxes during the year 1946 in the sum
11 of $262,272.80; that a copy of said refund claim above-referred to, together with the schedules and computations attached thereto, is attached to this Affidavit; that for the purposes of this proceeding the amount of refund claimed was computed as follows: the supplemental Revenue Agent's Report covering the Plaintiff's operations for the year 1944, dated March 31, 1948, reflected an adjusted net income for 1944 of $308,407.41, after allowance of net operating loss carry-back from 1946 of $310,872.60; the latter figure does not include any additions for excess profits taxes paid during 1946; the Plaintiff actually paid $263,272.80 in excess profits taxes during 1946; if the latter figure is added to the agreed net operating loss for 1946 of $310,872.60 and the aggregate of these two carried back to 1944, net income for 1944 is reduced to $45,134.61 and the adjusted excess profit net income becomes $61,172.43; because of the excess profits credit and unused excess profits credit carry-overs there would result an excess profits tax liability for 1944 of zero; that the remaining excess profits tax assessments (and payments) for the year 1944 not yet recovered by the Plaintiff by way of refund, all of which have been paid to the Collector of Internal Revenue, aggregate $148,841.72, which is the amount claimed as a refund in this proceeding, plus interest.

(S) Morris Sobin.
MORRIS SOBIN.

Subscribed and sworn to before me this 3rd day of July, 1952.

[SEAL] (S) Abraham Cooper,
Notary Public.

ABRAHAM COOPER,
Notary Public, State of New York

No 03-0752550. Qualified in Bronx County.
Cert. filed with Bronx & Queens Co. Clk. & Reg.
Term expires March 30, 1953.

12 *Exhibit to affidavit*

Form 843
Treasury Department
Internal Revenue Service

(Revised January 1946)

CLAIM

TO BE FILED WITH THE COLLECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Collector's stamp: (Date received) June 15, 1948.

☒ Refund or Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

STATE OF NEW YORK,
County of Queens, ss:

Type or print { Name of taxpayer or purchaser of stamps: Olympic Radio & Television, Inc., Successors to Hamilton Radio Corporation.
Business address: 34-01 38th Avenue (Street), Long Island City 1, New York (City).
Residence ----------

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete.

1. District in which return (if any) was filed 2nd New York.

2. Period (if for income tax, make separate form for each taxable year) from 1-1, 1944, to 12-31, 1944.

3. Character of assessment or tax: Income and Excess Profits Taxes.

4. Amount net assessment, $191,004.04; dates of payment, various.

5. Date stamps were purchased from the Government _____.

6. Amount to be refunded, exclusive of interest, $191,004.04.

7. Amount to be abated (not applicable to income, gift, or estate taxes) _____.

8. The time within which this claim may be legally filed expires, under section 322 of I. R. C. (Revenue Act or Internal Revenue Code), on March 15, 1949.

The deponent verily believes that this claim should be allowed for the following reasons:

The net operating loss for 1946 was not adjusted, as required under Section 122 (d) (6), for excess profits taxes paid or accrued during 1946. Taxpayer finally agreed to a deficiency in excess profits taxes (hence these taxes accrued in 1946) of $86,333.74. Moreover, taxpayer actually paid, in 1946, $306,072.41 in excess profits taxes.

OLYMPIC RADIO & TELEVISION, INC.,
(S) (Name illegible), *President.*
M. SOBIN, *Treasurer.*

Sworn to and subscribed before me this 11th day of June 1948.

Abraham Cooper,
ABRAHAM COOPER,
Notary Public, State of New York.

Residing in Bronx County.
Bronx Co. Clk.'s No. 177, Reg. No. 382–C–9.
Certificate filed in Queens Co. Clk.'s No. 3044, Reg. No. 422–C–9.
Commission expires March 30, 1949.

RE: OLYMPIC RADIO TELEVISION, INC.

RECOMPUTATION OF TAXES FOR 1944

Income tax

Net income per RAR		$619,280.01
Loss per RAR, 3/31/48	$310,872.60	
EPT def. agreed in 1946	86,333.74	
		397,206.34
		222,073.67
A. E. P. N. I.		142,008.24
Line X		80,065.43
Tax @ 40%		32,026.17

Excess profits tax

A. N. I. from above		222,073.67
Interest on borrowed capital, '44	$14,876.71	
Interest on borrowed capital, '46	1,161.11	
		16,037.82
		206,035.85
Adj. for 711 (a) (1) (J)		86,333.74
		292,369.59
Spec. Exp	$10,000.00	
E. P. Cr. (RAR-10-18-46)	55,451.34	
Unused E. P. C. (RAR-3-31-48)	84,910.01	
		150,361.35
A. E. P. N. I.		142,008.24
95%		134,907.83
80% of line X, above		64,051.34
Income tax		32,026.17
EPT		32,035.17
10% credit		3,202.52
Net EPT		28,822.65
Inc. tax		32,026.17
Final total tax		60,848.82
Total tax per orig. 1139		191,004.04
Refund due		130,155.22

15 *Defendant's response to plaintiff's motion for summary judgment and defendant's cross motion for summary judgment*

Filed August 12, 1952

Comes now the defendant by its Acting Assistant Attorney General and moves the Court to overrule the plaintiff's motion for summary judgment and to enter summary judgment against the plaintiff and in favor of the defendant in the above-entitled action because the pleadings and the evidence appended to the motions for summary judgment of the respective parties consisting of affidavits and exhibits show that there is no triable issue

as to any material fact and that the defendant is entitled to judgment as a matter of law.

In support of the within motion and in response to the
16 plaintiff's motion for summary judgment, the defendant will rely upon the pleadings and the evidence attached to the motions of the respective parties as well as the brief submitted herewith.

Respectfully submitted.

ELLIS N. SLACK,
Acting Assistant Attorney General.

ELIZABETH B. DAVIS,
Attorney.

CITY OF WASHINGTON,
District of Columbia, ss:

Elizabeth B. Davis, being duly sworn, says:

1. I am an attorney in the Tax Division of the Department of Justice, assigned to duty at Washington, D. C., and that in my official capacity I am counsel of record for the United States, the defendant in a cause of action now pending in the United States Court of Claims, styled and numbered as follows: Olympic Radio and Television, Inc. v. United States, No. 19–52.

2. In my official capacity as counsel of record for the defendant I am at the present time the custodian of the administrative files of the Bureau of Internal Revenue, Treasury Department containing the information, papers and documents in the
17 possession of the defendant relating to the issues involved in the aforesaid proceeding.

3. I have examined the administrative files in my custody and as the result thereof state the following facts which I believe to be true:

(a) That the express profits tax return of the Hamilton Radio Corporation (now the Olympic Radio and Television, Inc.) for the calendar year 1945 showed an excess profits tax liability of $346,643.22.

(b) That of the amount of $346,643.22, payments in a total amount of $261,939.28 were made in 1946 and the remaining amount of $84,703.94 satisfied by credit.

(c) A deficiency of $42,799.61 in excess profits tax and $4,164.46 in interest was assessed on the November, 1947, list, of which $42,799.61 was abated on Schedule IT–CB–8061 (this is the schedule showing allowance of tentative carry-back adjustments), and the balance of $4,164.46 was credited on the same schedule. Additional interest of $38.16 and $789.38 was assessed on June 17, 1947, and April 19, 1948, lists, respectively, and was paid by credit.

(d) That there were carry-back allowances made from 1947 to 1945, resulting in overassessments of 1945 excess profits tax being allowed of $189,642.35 and $199,800.48, or a total overassessment allowed of $389,442.83. The amounts of these overassessments were either refunded or credited during the years 1947 and 1948.

18 (e) The following is a summary of the foregoing assessments and adjustments of 1945 excess profits taxes:

		Excess profits tax
Originally assessed per return		$346,643.22
Deficiency assessed 11/47 (without interest)		42,799.61
Total assessments		389,442.83
Carry-back from 1947	$189,642.35	
Carry-back from 1947	199,800.48	
		389,442.83
Net assessment		None

ELIZABETH B. DAVIS.

Subscribed and sworn to before me this 8th day of August, 1952.

[SEAL] NELLIE G. PLUMLEY,
Notary Public.

19 *Argument and submission of case*

On October 7th and 8th, 1952, the case was argued and submitted on plaintiff's and defendant's motions for summary judgment by Mr. Frederick R. Tansill for plaintiff and by Mrs. Elizabeth B. Davis for defendant.

21 *Opinion of the court on plaintiff's and defendant's motions for summary judgment by Whitaker, J.; dissenting opinion by Madden, J., with which Jones, Ch. J. agrees*

Decided November 4, 1952

Mr. Frederick R. Tansill for the plaintiff. Mr. Eugene Meacham was on the briefs.

Mrs. Elizabeth B. Davis, with whom was Mr. Acting Assistant Attorney General Ellis N. Slack, for the defendant. Mr. Andrew D. Sharpe was on the brief.

OPINION ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Decided November 4, 1952

WHITAKER, Judge, delivered the opinion of the court:

The plaintiff sues for the recovery of $148,841.72 with interest asserting that the excess profits tax collected from it for the year 1941 was larger, by that amount, than it should have had to pay.

The plaintiff, a manufacturer of radio and television sets, paid in 1945 an excess profits tax on its 1944 profits in the total amount of $623,454.52. In 1946 it paid an excess profits tax of $263,272.80 on its 1945 profits. The plaintiff's return for 1946 showed no income tax liability, but instead a net operating loss of $324,844.23 reduced by the Bureau of Internal Revenue upon audit to $310,872.60. This operating loss for 1946, under the law, could be "carried back" to the year 1944. When this was done, it reduced the plaintiff's excess profits taxes for 1944 from the $623,454.52, which it had paid, to a considerably lesser sum. The amount of that reduction has been received by the plaintiff, by pay-
22 ment or credit. The plaintiff says, however, that to its net operating loss of $310,872.60 for 1946 there should have been added the $263,272.80 which it paid in 1946 on its 1945 excess profits, and that the sum of these two figures, instead of the first figure only, should have been carried back to reduce the 1944 excess profits net income. If that had been done, it would have reduced the 1944 excess profits tax by the amount claimed in this suit.

Section 122 of the Internal Revenue Code, which is entitled "Net Operating Loss Deduction" provides:

"(a) DEFINITION OF NET OPERATING LOSS.—As used in this section, the term net operating loss means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

* * * * *

"(d) EXCEPTIONS, ADDITIONS AND LIMITATIONS.—The exceptions, additions and limitations referred to in subsections (a) (b) and (c) shall be as follows:

* * * * *

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year."

Subchapter E of Chapter 2 is the part of the Code providing for excess profits taxes. Subsection (b) of Section 122 provides that if the taxpayer has a net operating loss for any taxable year, that net operating loss may be carried back to the two preceding taxable years, to reduce the income for those years.

The plaintiff, relying on the statutes referred to above, says that by Section 122 (d) (6) its excess profits tax paid in 1946 was includible in its "net operating loss" and therefore could be carried back to 1944, the second preceding taxable year, to reduce its income for that year. The Government says that these statutory provisions do not permit the plaintiff to do so, because the plain-

tiff was on the accrual basis for the computation of its income for tax purposes, and the tax which it desires to carry back, though paid in 1946 when the plaintiff had a net operating loss, accrued in 1945 when it did not have a net operating loss, and would not have had such a loss even if this tax had been deducted from its 1945 income. The Government points to Section 43 of the Code which says:

"The deductions and credits * * * provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed * * *."

Then it points to Section 23 which says:

DEDUCTIONS FROM GROSS INCOME

"In computing net income there shall be allowed as deductions:

"(s) * * * the net operating loss deduction computed under section 122."

Both Sections 43 and 23 are in Chapter 1 of the Code. Section 48 (c) also contains a definition similar to that of Section 43.

The statutory texts quoted above put a heavy burden on the plaintiff to show that it, being on the accrual basis for tax purposes, could take, in 1946, a deduction of excess profits taxes which accrued in 1945, though they were paid in 1946. The plaintiff's contention is that if the statutory definition of "paid or accrued" is applied to the excess profits tax situation, the deduction which the statute seems to tender to taxpayers is largely illusory, so far as taxpayers on the accrual basis of tax accounting are concerned. This would seem to be true, since it would be only rarely that a taxpayer would accrue a liability for an excess profits tax in a year in which it had a net operating loss.

According to the letter of the statutes, plaintiff is not entitled to deduct in the year 1946 taxes which accrued for the year 1945 but which were paid in 1946. When the statute referred to deductions "paid or accrued" in the taxable year, it referred to deductions paid in the taxable year if the taxpayer was on a cash basis, and to deductions accrued within the taxable year if the taxpayer was on the accrual basis. It is also true that in computing one's income, either one basis or the other must be used, and that one cannot be used for certain deductions and the other for others.

Notwithstanding all this, we think that in order to give effect to the intention of Congress we must permit this taxpayer to deduct excess profits taxes paid in the calendar year 1946, although they accrued for the year 1945. We think so, for this reason: It was the clear intention of Congress that a taxpayer should be permitted to carry back to a former year his loss in a subsequent year,

and that to this loss there should be added excess profits taxes "paid or accrued" in the calendar year.

Now, if we follow the letter of the statute, a taxpayer on an accrual basis would be denied the deduction of excess profits taxes, in practically all cases, if he is limited to the excess profits taxes accrued within the taxable year. There is rarely a case when a taxpayer would be liable for any excess profits tax in a year in which it had sustained a net operating loss; and, yet, Congress certainly intended that it should get the benefit of the deduction of excess profits taxes for some year. In order for it to get this deduction it would seem that it should be entitled to deduct the excess profits taxes which it paid in the taxable year, although they had accrued in the prior year.

It seems to us, therefore, that we must make an exception in this case to the general rule prohibiting the shifting from the "paid" to the "accrued" basis, or vice versa, in the case of specific deductions. Otherwise, we cannot give effect to the plain intention of Congress. We realize this does violence to the letter of the Act, but we are so thoroughly convinced of the intention of Congress that we feel justified in disregarding the letter in order to give effect to that intent. After all, it is the intention of Congress which we must enforce, however that intention may be divined.

No cases exactly in point have been cited to us nor have we found any; however, several of the Courts of Appeal have held that in applying the tax levied on undistributed net income, the expression "paid or accrued" need not be given its customary meaning.

In Birmingham, et al., v. The Loetscher Company, 188 F. 2d 78 (C. A. 8) the court held that a cash basis taxpayer could, under Section 505 (a) (1) of the Internal Revenue Code, deduct both taxes for a prior year paid within the taxable year and taxes accrued but not paid within the taxable year, in determining its undistributed net income for the purposes of the penalty tax on such net income. The court there relied on a holding in Commissioner v. Clarion Oil Company, 148 F. 2d 671, 80 U. S. App. D. C. 41, which, while it permitted a cash basis taxpayer to deduct taxes accrued but not paid within the tax year, refused to permit it to deduct taxes paid within the year but accrued in a prior year. In Aramo-Stiftung v. Commissioner, 172 F. 2d 896 (C. A. 2) the court permitted a cash basis taxpayer to deduct income taxes accrued but not paid within the taxable year, in determining its Section 505 (a) (1) taxable income. See also Wm. J. Lemp Brewing Company, 18 T. C. —, No. 70.

These cases support plaintiff's contention that the definitions of the term "paid or accrued" in sections 43 and 48 (c) should not be applied in all circumstances and regardless of consequences.

The Tax Court in Lewyt Corporation v. Commissioner, 18 T. C. ——, No. 151, has decided the question here involved adversely to plaintiff's contention. We regret that we are unable to agree.

Defendant's motion is denied, and plaintiff's motion for summary judgment is granted. Judgment will be entered in plaintiff's favor against the defendant in the amount of one hundred forty-eight thousand eight hundred forty-one dollars and seventy-two cents ($148,841.72), with interest as provided by law.

It is so ordered.

HOWELL, Judge; and LITTLETON, Judge, concur.

Madden, Judge, dissenting

I think the plaintiff is not entitled to recover. The Birmingham, Clarion Oil Company and Aramo-Stiftung cases, cited in the court's opinion, involved the penalty tax on undistributed profits. To penalize a corporation for not distributing as dividends money which it either does not have, because it pays it out in back taxes during the year, or which prudence would require it to keep, because it will be needed to pay taxes accrued during the year
26 though not payable until the following year, would seem to amount to penalizing sound management. The instant situation presents no comparable pressure of equity against the text of the statutes. The carry-back provision of the statutes does not permit the taxpayer to average its profit and loss experience for a five-year period. It only permits net operating losses, as determined by statutory provisions, to be carried back. To get the advantage of the statute, its requirements should be met. The Tax Court, in Lewyt Corporation v. Commissioner, 18 T. C. ——, No. 151, has decided the same question which is involved in our case, adversely to the plaintiff's contentions. I agree with its decision.

Chief Judge Jones agrees with this dissenting opinion.

27 *Motion for the United States for rehearing*

Filed Dec. 3, 1952

The United States, defendant herein, moves the Court for a rehearing in the above-entitled case for the following reasons:

1. This Court erred in ignoring the plain provisions of Sections 48 (c) and 122 (d) (6) of the Internal Revenue Code in allowing the plaintiff on the accrual basis to increase its net operating loss for 1946 by excess profits taxes which were paid in that year, but were not a proper accrual in that year.

2. The Court erred in making an exception to the general rule, prohibiting the shifting from the "paid" to the "accrual"
28 basis, in order to give effect to what is considered the plain intention of Congress.

3. The Court erred in concluding that it was the intention of Congress to allow a taxpayer on the accrual basis to increase its net operating loss under Section 122 (d) (6) of the Internal Revenue Code by amounts which were not proper accruals in the year of the net operating loss.

4. The Court erred in granting plaintiff's motion for summary judgment and entering judgment for the plaintiff.

Wherefore, the defendant prays that this motion be set for oral argument; that defendant's motion be granted for the reasons set forth above and also in a brief attached hereto; and that judgment be entered in favor of the defendant.

Respectfully submitted.

CHARLES S. LYON,
Assistant Attorney General.

ELIZABETH B. DAVIS,
Attorney.

28A *Motion for the plaintiff in opposition to the motion for the United States for rehearing*

Comes now the plaintiff, through its counsel of record, and respectfully moves this Court to grant this Motion and to deny the defendant's Motion for Rehearing for the following reasons:

1. The Opinion of this Court in the subject proceeding was correct as a matter of law.

2. This Court did not err as alleged in the defendant's Motion.

3. The single issue presented in this proceeding involves a question of law and all facts were either admitted in the pleadings or covered by unopposed affidavits.

4. The defendant had, prior to the filing of defendant's Motion for Rehearing, an opportunity for arguing the issue of law
28B here involved in open Couht and filed a brief in support thereof. The defendant's Brief in Support of this Motion fails to advance any significantly new and different arguments from those already presented to this Court, hence no good purpose would be served by setting this proceeding for reargument.

Wherefore, the plaintiff respectfully prays that this Motion be granted for the reasons set forth in the plaintiff's briefs as heretofore filed, for the reasons set forth in this Court's Opinion as well as for the reasons set forth in the Brief attached hereto; that the defendant's Motion for Rehearing and for oral argument be de-

nied and that this Court's Judgment in this proceeding remain as entered.

Respectfully submitted.

(S) Eugene Meacham,
EUGENE MEACHAM,
Counsel of Record,
824 Connecticut Avenue NW.,
Washington 6, D. C.

29 *Argument and submission of case*

On motion for rehearing

February 3, 1953

On February 3, 1953, the case was argued and submitted on Defendant's motion for rehearing by Mrs. Elizabeth B. Davis for Defendant, and by Mr. Frederick R. Tansill for plaintiff.

31 *Opinion of the Court on defendant's motion for rehearing by Whitaker, J.; Madden, J., and Jones, Ch. J. adhere to the views expressed in their former dissenting opinion*

Decided March 3, 1953

Mr. Frederick R. Tansill for the plaintiff. Mr. Eugene Meacham was on the briefs.

Mrs. Elizabeth B. Davis, with whom was Mr. Acting Assistant Attorney General Ellis N. Slack, for the defendant. Mr. Andrew D. Sharpe was on the briefs.

WHITAKER, Judge, delivered the opinion of the court:

In our opinion on plaintiff's and defendant's motions for summary judgment filed November 4, 1952, we held that the words "paid or accrued" in section 122 (d) (6) of the Internal Revenue Code must be construed as permitting a deduction for excess profits taxes paid in the taxable year in which a loss had been sustained, although the taxpayer filed its returns on an accrual basis; and we accordingly granted plaintiff's motion for a summary judgment.

Defendant has now filed a motion for a rehearing in which it presents a persuasive argument that our decision is wrong, but after careful consideration of defendant's motion and the authorities cited, we adhere to our former opinion.

However, defendant in its motion for a rehearing calls our attention to the provisions of sections 711 (a) (1) and 711 (a) (2) of the Revenue Act of 1940 (54 Stat. 976), to which subsections (J) and (L) were added by sections 210 (a) and 210 (b)

of the Revenue Act of 1942 (56 Stat. 907 and 908), which read in part as follows:

32 EXCESS PROFITS NET INCOME

"(a) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1939.—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

"(1) EXCESS PROFITS CREDIT COMPUTED UNDER INCOME CREDIT.—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

"(J) NET OPERATING LOSS DEDUCTION ADJUSTMENT.—The net operating loss deduction shall be adjusted as follows:

"(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, * * *.

"(2) EXCESS PROFITS CREDIT COMPUTED UNDER INVESTED CAPITAL CREDIT.—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

"(L) NET OPERATING LOSS DEDUCTION ADJUSTMENT.—The net operating loss deduction shall be adjusted as follows:

"(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, * * *."

In computing the credit which the Act allows to be taken against excess profits net income, subsections (J) and (L) plainly forbid the deduction of the excess profits taxes in question in this case, whether or not they were paid or accrued within the taxable year.

Section 122 (d) (6) of the Internal Revenue Code permits a deduction of excess profits taxes paid or accrued within the taxable year in computing the net operating loss deduction, but when a taxpayer comes to compute his excess profits credit against excess profits net income, he is denied this deduction. The result is that the deduction allowed by section 122 (d) (6) can be used only in the computation of the ordinary corporate income
33 tax and the corporation surtax net income, but it cannot be used in the computation of the excess profits tax.

Plaintiff seems to admit that this is correct where the excess profits tax is computed under section 710 (a) (1) (A) of the Revenue Act of 1942, but it says that it is not correct when the

excess profits tax is computed under section 710 (a) (1) (B) of the Revenue Act of 1942.

Section 710 (a) (1) provides that the excess profits tax shall be the lesser sum computed under subsection (A) and subsection (B). Subsection (A) provides for a tax of 90 per centum of the adjusted excess profits net income, increased to 95 per centum by the Revenue Act of 1943. Subsection (B) provides for a tax which shall be "an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, * * *."

Plaintiff says that when it computed its tax under subsection (B), it arrived at a figure which was less than that computed under subsection (A), and, therefore, that the tax to be demanded of it as a tax computed under subsection (B); and then it says that in computing the excess profits tax under subsection (B) it is not prohibited from deducting the excess profits taxes paid or accrued in another year in which it had sustained a loss.

We think this position is sound.

Section 711 (a) provides that the excess profits net income, upon which the excess profits tax is levied, shall be the normal tax net income with the following adjustments:

"If the excess profits credit is computed under section 713, the adjustments shall be as follows: * * * [subsection (1)]."

Subsection (J) (i) provides for the "net operating loss deduction adjustment." It says, "The net operating loss deduction shall be adjusted as follows:"

"(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, * * *."

34 The same restriction is made if the excess profits credit is computed under section 714.

Therefore, when a taxpayer goes to compute his excess profits tax under section 710 (a) (1) (A) he cannot take credit for "any excess profits tax imposed by this subchapter"; and he must pay 95 per centum of his excess profits net income, less the adjustments allowed, which exclude an adjustment for excess profits taxes paid in another year.

However, section 710 (a) (1) provides that if the amount of the excess profits tax computed under subsection (A) is greater than the amount computed under subsection (B), then the taxpayer is required to pay only the amount computed under subsection (B).

So, the taxpayer proceeds to compute its excess profits tax under subsection (B). This subsection provides that the tax is "an

amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter)."

It will be seen that in computing the tax under subsection (B), the taxpayer is not concerned with its adjusted excess profits net income. What it is concerned with is the tax imposed under Chapter 1, which is the normal corporation tax and the corporation surtax net income. This subsection says that the excess profits tax, as computed under it, is the difference between 80 per centum of the corporation surtax net income and the normal corporation income tax.

When computing the tax under subsection (B), no regard is to be had to the excess profits net income, but only to the ordinary net income and the corporation surtax net income. No one denies that in computing the ordinary net income that the taxpayer is permitted to carry back or forward the net operating loss in another year, which net operating loss includes a deduction for the excess profits tax paid or accrued within the taxable year in which there was a loss. This is also true in the computation of the surtax net income.

Section 711 (a) relates alone to the computation of the ex-
35 cess profits net income; it does not relate to the computation of the ordinary corporate net income nor to the surtax net income; hence, the prohibition therein contained against the deduction of excess profits taxes in a year in which a loss was sustained does not apply when a corporation is computing its ordinary net income or its surtax net income.

Therefore, inasmuch as this taxpayer's tax was computed under section 710 (a) (1) (B) of the Revenue Act of 1942, and since the tax imposed by this section is not based on excess profits net income, the limitation imposed by subdivision (J) (i) of section 711 (a) (1) and subdivision (L) (i) of section 711 (a) (2) is not applicable.

It results that the judgment heretofore entered in the sum of $148,841.72 will stand.

HOWELL, Judge, and LITTLETON, Judge, concur.

MADDEN, Judge, and JONES, Chief Judge, adhere to the views expressed in their former dissenting opinion.

37 [Clerk's certificate to foregoing transcript omitted in printing.]

U. S. GOVERNMENT PRINTING OFFICE: 1953

21 Supreme Court of the United States

No. 10, October Term, 1954

THE UNITED STATES, PETITIONER

vs.

OLYMPIC RADIO AND TELEVISION, INC.

Order allowing certiorari

Filed October 14, 1954

The petition herein for a writ of certiorari to the United States Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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In the Supreme Court of the United States

OCTOBER TERM, ~~1952~~ 1953

No. ~~829~~ 200

THE UNITED STATES OF AMERICA, PETITIONER

v.

OLYMPIC RADIO AND TELEVISION, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Acting Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims entered in this case on November 4, 1952, rehearing denied, March 3, 1953.

OPINIONS BELOW

The original opinion of the Court of Claims (R. 10–14) and the dissenting opinion, entered November 4, 1952, are reported in 108 F. Supp. 109. The opinion on rehearing (R. 16–19), entered March 3, 1953, is reported in 110 F. Supp. 600.

JURISDICTION

The opinion and judgment of the Court of Claims were entered November 4, 1952. (R. 14.) On December 3, 1952, the Government filed a motion

for rehearing. On March 3, 1953, the court denied the motion. (R. 19.) The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255 (1).

QUESTION PRESENTED

Whether, under Section 122 (d) (6) of the Internal Revenue Code, a taxpayer on the accrual basis can, in computing its net operating loss for one year, deduct the amount of excess profits taxes paid in that year but which accrued in an earlier year.

STATUTE INVOLVED

The applicable portions of the pertinent statute are set forth in the Appendix, *infra*, pp. 12–18.

STATEMENT

This case was submitted to the court below on motions for summary judgments filed by both parties, together with supporting affidavits. The facts, which are not in dispute, are briefly as follows:

Taxpayer, a corporation, keeps its books and accounts and files its income tax returns on the accrual basis. (R. 1.) Its income tax return for the year 1946 disclosed no income tax liability and reflected a net operating loss of $324,844.23. (R. 2.) Upon the audit of the taxpayer's income tax return for the year 1946, the Commissioner of Internal Revenue reduced the net operating loss for the year 1946 to $310,872.60. (R. 2.) Taxpayer, in its excess profits return for the year 1945, reported an excess profits tax liability of $346,643.22. Of this amount $263,272.80 was paid in 1946. (R. 2.)

Taxpayer duly filed a claim for refund of income and excess profits taxes for the year 1944 in the amount of $191,004.04. This claim was based on the ground that the excess profits taxes for 1945 paid during 1946 should be added to the agreed net operating loss for 1946 under Section 122 (d) (6) of the Internal Revenue Code. The amount of $263,272.80, the excess profits tax for 1945, paid in 1946, was later refunded or credited to the taxpayer, as a result of the allowance of carry-backs for 1947. (R. 10.)

The Court of Claims (Madden, J., with whom Jones, C. J., concurred, dissenting) held that, in computing its net operating loss for 1946, the taxpayer was entitled to deduct the amount of the excess profits taxes shown on its 1945 return and paid in 1946. The court entered judgment in favor of the taxpayer in the amount of $148,841.72, with interest. (R. 14.)

REASONS FOR GRANTING THE WRIT

1. As the Court of Claims expressly recognized (R. 14), its decision, allowing an accrual basis taxpayer to increase its net operating loss by the amount of an earlier-accrued excess profits tax actually paid in the taxable year, is in direct conflict with that of the full Tax Court, rendered without dissent, in *Lewyt Corp.* v. *Commissioner*, 18 T. C. 1245. See, also, *W. L. Maxson Corp.* v. *Commissioner*, decided January 26, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,021). And see *Estate of Byrne* v. *Commissioner*, 16 T. C. 1234, deciding the same issue

in favor of the Government without extended discussion.

In the *Leuyt* case, the Tax Court held (18 T. C. at 1249–1253), in square conflict with the decision below, that an accrual basis taxpayer cannot, under Code Section 122 (d) (6) [1] (Appendix, *infra*, p. 14), increase its net operating loss for a particular year for carry-back purposes by the excess profits tax which was paid in that year but which accrued in a prior year. The basis for the decision of the Tax Court was that, while Section 122 (d) (6) allows as a deduction the excess profits tax "paid or accrued within the taxable year," the alternative verbs "paid or accrued" were used to comprehend, and distinguish between, taxpayers on a cash or accrual basis (*i. e.*, "paid," if on

[1] Section 122 (a) of the Code defines the "net operating loss", which may be carried back to and be deducted in two previous years under Code Sections 23 (s) and 122 (b) (1) and (c) (Appendix, *infra*, pp. 12, 13–14), as the excess of the deductions "allowed by this chapter", *i. e.*, the chapter imposing the income tax, over the gross income, with the exceptions, additions, and limitations provided in subsection (d). Section 122 (d) (6) provides that there shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2, *i. e.*, the excess profits tax, "paid or accrued within the taxable year." Section 48 (c) (Appendix *infra*, p. 13) provides that when used in this chapter, *i. e.*, the chapter imposing the income tax and the chapter containing Section 122 (d) (6), the term "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed, and Section 43 (Appendix, *infra*, pp. 12–13) provides that the deductions provided for in this chapter, *i. e.*, the income tax chapter containing Section 122 (d) (6), shall be taken for the taxable year in which "paid or accrued", dependent upon the method of accounting on the basis of which net income is computed.

cash basis, and "accrued," if on accrual basis), and were not designed to give an accrual basis taxpayer the right to deduct its excess profits tax in the year paid, if the tax accrued in another year.[2] See Code Sections 43 and 48 (c) (Appendix, *infra*, pp. 12–13), and see footnote 1, *supra*. This conflict between the Court of Claims and the Tax Court on a question of such recurrent importance in the administration of the tax law would seem to require resolution by this Court at this time.[3] We are informed by the Department of the Treasury that the same issue is presented in at least 35 (and probably more) other cases now pending before the Court of Claims, the district courts, the Tax Court, and the Treasury, involving a total of at least $27,000,000 in taxes, plus interest. Other taxpayers will doubtless raise the same question in other cases.[4]

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[2] The holding that the term "paid or accrued" in Section 122 (d) (6) refers to the accounting method employed in computing income was reaffirmed in *Robert Reis & Co.* v. *Commissioner*, 20 T. C. No. 36. The *Reis* case involved a situation where the liability for the excess profits tax was contested. It was held that the tax did not "accrue" in the year for which it was incurred, but that it accrued when the contest was settled and the tax was paid, under *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516.

[3] The Court's decision in the *Lewyt* case was entered April 9, 1953, and final decision has not yet been entered in the *Maxson* case. Thus, the time within which to file appeals to the Court of Appeals for the Second Circuit, the reviewing court for those cases, has not yet expired, and we understand the taxpayers will appeal.

[4] Even though the excess profits tax was repealed for years ending after December 31, 1945 (Sec. 122 (a), Revenue Act of 1945, c. 453, 59 Stat. 556), the statutory period for filing

2. The decision of the Court of Claims departs from the principle, established in numerous decisions of this Court, that a taxpayer on the accrual basis must take deductions in the year in which they accrue, regardless of when paid. *United States* v. *Anderson*, 269 U. S. 422; *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92; *Security Mills Co.* v. *Commissioner*, 321 U. S. 281. Cf. *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516. Furthermore, the court below recognized that the clear language of the statute (Secs. 43, 48 (c) and 122 (d) (6) (see fn. 2, *supra*)), forbids an accrual basis taxpayer to deduct in one year excess profits taxes paid in that year but which accrued in an earlier year (R. 12). Nevertheless the court thought that it should read an exception into the statute and permit the claimed deduction in order to give effect to what it believed

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claims for net operating loss deductions does not expire until 39 months after the end of the taxable year of the net operating loss (Sec. 322 (b) (6), Internal Revenue Code (26 U. S. C. 1946 ed., Sec. 322)). It is probable also that in a number of instances waivers have been filed which will extend the statutory period. (Sec. 322 (b) (3), Internal Revenue Code.) Moreover, since Section 122 (d) (6) applies in connection with determination of net operating losses up to and including the year ended June 30, 1950 (Sec. 304, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137), the same issue can arise for all years prior to that date where the liability for excess profits taxes for years prior to 1946 was being contested and the taxes were accordingly not paid or accrued until a later year when the contest was settled. In *Robert Reis & Co.* v. *Commissioner*, *supra*, n. 2, the loss year was 1949.

was the intention of Congress (R. 13).[5] It reasoned that Congress must have intended that an accrual basis taxpayer should be allowed to deduct excess profits taxes paid but not accrued in the tax year in determining its net operating loss for that year because, otherwise, an accrual basis taxpayer would be denied the benefit of deducting excess profits taxes "in practically all cases", the court assuming that only rarely would excess profits taxes accrue in a year when an operating loss was sustained. (R. 13.) Even if the court were correct in its assumption, that could not justify disregard of the plain language of the statute.[6] As this Court recently

[5] *Birmingham* v. *Loeischer Co.*, 188 F. 2d 78 (C. A. 8); *Aramo-Stiftung* v. *Commissioner*, 172 F. 2d 896 (C. A. 2); and *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (C. A. D. C.), certiorari denied, 325 U. S. 881, construing the words "paid or accrued" as used in Section 505 (a) of the Internal Revenue Code (26 U. S. C. 1946 ed., Sec. 505), dealing with the penalty surtax on the undistributed profits of personal holding companies, furnish no support for the decision of the majority of the court below. See dissenting opinion of Judge Madden (R. 14) and the opinion of the Tax Court in *Lewyt Corp.* v. *Commissioner*, 18 T. C. 1245, 1252.

[6] If the principle of *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516, is applicable to federal income and excess profits taxes, an accrual basis taxpayer would get the benefits of this section where taxes for prior years were contested and not settled until the loss year. Although the Commissioner of Internal Revenue has recently taken the position before the Tax Court that the *Dixie Pine Co.* case is not governing with respect to federal income or excess profits taxes and that such tax "accrues" in the accounting period for which levied, this position was rejected in the recent case of *Robert Reis & Co.* v. *Commissioner*, 20 T. C. No. 36. The court also pointed out in that case that its holding therein, allowing an accrual

reiterated, provisions of tax law cannot be bent in particular cases in order to avoid "hardship" to the taxpayer or the Government. *Healy* v. *Commissioner*, 345 U. S. 278, 284–285. And see *Riley Co.* v. *Commissioner*, 311 U. S. 55, 59; *United States* v. *Hill*, 248 U. S. 420; *Commissioner* v. *Hecht Co.*, 163 F. 2d 194 (C. A. 4); and *Sabine Transp. Co.* v. *Commissioner* 128 F. 2d 945, 947 (C. A. 5); cf. *Helvering* v. *Twin Bell Syndicate*, 293 U. S. 312, 321.

As the Court stated in *Crooks* v. *Harrelson*, 282 U. S. 55, 60, to justify a court's departure from the terms of the statute "there must be something to make plain the intent of Congress that the letter of the statute is not to prevail." The Court of Claims here did not, and indeed could not, rely upon any legislative history to support its assumptions as to the "intent" of Congress. (See the Tax Court's discussion of the legislative history in *Lewyt Corp.* v. *Commissioner*, 18 T. C. 1245, 1251–1252). As Judge Madden stated in his dissenting opinion, to get the advantage of a net operating loss granted by the statute, the statute's "requirements should be met."[7]

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basis taxpayer to deduct, in computing its net operating loss for 1949, excess profits taxes for 1943 and 1944 which were in dispute and not settled until 1949, refutes a contention made by the taxpayer in the *Lewyt* case, *supra*, that to construe "paid or accrued" as used in Section 122 (d) (6) as referring to the taxpayer's method of accounting would deny accrual basis taxpayers any benefit under the section.

[7] In its motion for rehearing the Government again pointed out to the court below that its decision was inconsistent with Section 711 (a) (1) (J) and (a) (2) (L) of the Internal Revenue Code, which provides, for purposes of adjusting the excess profits net income, that in computing the net operating loss for

(R. 14.) Cf. *Reo Motors* v. *Commissioner*, 338 U. S. 442; *Standard Paving Co.* v. *Commissioner*, 190 F. 2d 330 (C. A. 10).

Furthermore, the court erred in rejecting the Government's contention that, since the excess profits taxes for 1945, which were claimed as a deduction in 1946 in computing the net operating loss, were later refunded or credited in full as a result of a net operating loss carry-back from 1947, the taxpayer did not suffer any real economic loss and was therefore not entitled to increase its operating loss deduction by a tax liability which was eliminated. The purpose of Section 122 (d) was to prevent "net losses from being used as a deduction by the taxpayer where he is not suffering any economic loss."

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any taxable year under Section 122 (a) and 122 (d) (6) (Appendix, *infra*, pp. 13, 14–15), "no deduction shall be allowed for any excess profits tax imposed by this chapter." The court below rejected that contention in its opinion on rehearing (R.19). The effect is to allow all excess profits taxes, both paid and accrued, to be deducted in arriving at the net operating loss to be carried back for income tax purposes, but not to allow any excess profit taxes to be deducted in arriving at the net operating loss to be carried back for excess profits tax purposes—a result which would seem inconsistent with any probable Congressional intention. Further, the court below erred in holding that Section 711 (a) (1) (J) and (a) (2) (L) do not apply even if taxpayer's excess profits tax liability for 1944 is to be determined under Section 710 (a) (1) (B). This result requires that the net operating loss for purpose of the two alternative computations of the excess profits tax be calculated in two different ways, again a highly improbable result. Compare *Sokol Bros. Furniture Co.* v. *Commissioner*, 185 F. 2d 222 (C. A. 5), certiorari denied, 340 U. S. 952, with *Basalt Rock Co.* v. *Commissioner*, 180 F. 2d 281 (C. A. 9), certiorari denied, 339 U. S. 966.

H. Rep. No. 855, 76th Cong., 1st Sess., p. 17 (1939–2 Cum. Bull. 504, 517). The taxpayer clearly should not be allowed to use the amount of excess profits taxes for 1945, which were paid but later refunded, to increase in a fictitious amount a net operating loss to be carried back to an earlier year.[8]

3. The decision below, if allowed to stand, may lead to completely anomalous consequences. Under it all taxpayers, whether on the cash or accrual basis of accounting, would appear to be able to deduct *all* excess profits taxes, both paid and accrued within any taxable year, for purposes of determining their net operating losses.[9] The decision could also result in allowing the excess profits taxes paid for a particular year to be used as a carry-back to wipe out or reduce the excess profits tax liability for that year. For example, if the net operating loss for 1946 here, resulting from the allowance of a deduction of the 1945 excess profits taxes, exceeded the 1944 net

[8] Cf. *Arrowsmith* v. *Commissioner*, 344 U. S. 6, where this Court, in determining the *nature* of a transaction which took place in 1944, considered events occurring in later years.

[9] In *Ohio Boxboard Co.* v. *Carey*, Civil No. 28356, now pending in the District Court for the Northern District of Ohio, a taxpayer with a net income for 1944 of $1,740,718.29 as determined by the Commissioner of Internal Revenue, is claiming the right to deduct 1943 excess profits taxes paid in 1944 of approximately $1,000,000 and also to deduct 1944 excess profits taxes accrued in that year of approximately $1,000,000, thus resulting in a claimed net loss of over $400,000.

income after necessary adjustments under Section 122 (d), the excess would be a carry-over to 1945 under Section 122 (b) (1) (Appendix, *infra*, pp. 13–14) and would be claimed as a deduction against the excess profits tax liability for 1945.[10] Thus, the 1945 excess profits taxes would be a factor in wiping out or reducing the very liability which they were paid to satisfy. Certainly, such incongruous results could not have been intended by Congress.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted.

ROBERT L. STERN,
Acting Solicitor General.

MAY, 1953.

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[10] Such a claim was made in the *Lewyt* case before the Tax Court, but in view of that court's holding that the excess profits taxes were not deductible in computing the net operating loss deduction, the basis for the claim was eliminated.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [as added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 43 [as amended by Sec. 134 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the accrual method of accounting, amounts (except amounts includible in computing a partner's net income under section 182) accrued as deductions and credits only by reason of the death of the taxpayer shall

not be allowed in computing net income for the period in which falls the date of the taxpayer's death.

(26 U. S. C. 1946 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) *"Paid or Incurred," "Paid or accrued."*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 1946 ed., Sec. 48.)

SEC. 122 [as added by Sec. 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [as amended by Sec. 105 (e) (3) (A) of the Revenue Act of 1942, *supra*] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Sec. 153 (a) of the Revenue Act of 1942, *supra*] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions,

additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * * * *

(c) [as amended by Secs. 105 (e) (3) (B) and 153 (b) of the Revenue Act of 1942, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26 (e));

(d) [as amended by Sec. 105 (e) (3) (C) of the Revenue Act of 1942, *supra*] *Exceptions, Additions, and Limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

* * * * *

(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U. S. C. 1946 ed., Sec. 122.)

SEC. 710 [as added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974].

IMPOSITION OF TAX.

(a) [as amended by Sec. 201 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Imposition.*—

(1) [as amended by Sec. 202 of the Revenue Act of 1942, *supra*] *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) [as amended by Sec. 202 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] 95 per centum of the adjusted excess profits net income, or

(B) [as amended by Sec. 202 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21] an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided

in section 26 (e) (relating to income subject to the tax imposed by this subchapter), and without regard to 80 per centum of the credit provided in section 26 (h) (relating to credit for dividends paid on certain preferred stock).

* * * * *

(b) *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

(1) [as amended by Sec. 204 of the Revenue Act of 1943, *supra*] *Specific exemption.*—A specific exemption of $10,000;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under section 712; and

(3) [as amended by Sec. 2 (a) of the Excess-Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and Sec. 204 (a) of the Revenue Act of 1942, *supra*] *Unused excess profits credit.*—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

* * * * *

(26 U. S. C. 1946 ed., Sec. 710.)

SEC. 711 [as added by Sec. 201 of the Second Revenue Act of 1940, *supra*]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(J) [as added by Sec. 210 (a) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; * * *

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(L) [as added by Sec. 210 (b) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year

under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year; * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 711.)

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No. 10

In the Supreme Court of the United States

OCTOBER TERM, 1953

THE UNITED STATES OF AMERICA, PETITIONER

v.

OLYMPIC RADIO AND TELEVISION, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM IN REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 100

THE UNITED STATES OF AMERICA, PETITIONER

v.

OLYMPIC RADIO AND TELEVISION, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM IN REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

Respondent's brief in opposition contends that the petition for a writ of certiorari was not filed within the statutory period. The principal basis for this contention is this Court's decision in *Federal Trade Commission* v. *Minneapolis Honeywell Regulator Co.*, 344 U. S. 206. That case, however, is wholly inapposite.

The opinion and judgment of the Court of Claims were entered November 4, 1952. (R. 14.) On December 3, 1952, within 30 days of the entry of the original judgment, the Government filed a motion for rehearing. This motion was timely filed. Rule 53 (c) of the Court of Claims. On

March 3, 1953, the court denied the motion with an opinion. (R. 19.) The petition for a writ of certiorari was filed May 29, 1953.

Respondent contends that, inasmuch as the Court of Claims did not vary the terms of the November 4 judgment when it denied the motion for rehearing, the time within which the petition for writ of certiorari could be filed begar to run on November 4 and expired February 2, 1953. It is urged, therefore, that under *Minneapolis Honeywell* the petition is out of time.

But *Minneapolis Honeywell* did not deal with a timely motion for rehearing in the court below (cf. *Federal Power Commission* v. *Idaho Power Co.*, 344 U. S. 17, 19–20, n. 1, p. 21), and did not purport to change the long established rule that timely motions for rehearing toll the time for filing a petition for certiorari until 90 days after the disposition of the rehearing motion. *Department of Banking* v. *Pink*, 317 U. S. 264, 266; *Pfister* v. *Northern Illinois Finance Corp.*, 317 U. S. 144, 149–150; *Morse* v. *United States*, 270 U. S. 151; cf. *Wayne United Gas Co.* v. *Owens-Illinois Glass Co.*, 300 U. S. 131, 137. Here, where the motion for rehearing was timely filed in the Court of Claims, the 90 day period did not commence until the decision of that court on March 3, 1953, and did not expire until June 1, 1953. As the petition for certiorari was filed May 29, it was timely.

The petitioner, Federal Trade Commission, in the *Minneapolis Honeywell* case attempted to sustain the timeliness of the petition for a writ of certiorari on two well settled rules: (1) that when a court considers on its merits an untimely petition for a rehearing, or an untimely motion to amend matters of substance in a judgment, the time for appeal may begin to run anew from the date on which the court disposed of the untimely petition, and (2) that when a court actually changes its judgment, the time to appeal or petition begins to run anew irrespective of whether a petition for rehearing has been filed. This Court's decision did not question the correctness of these two general propositions but held them to be inapplicable to the facts of that case. Reliance upon the first proposition was held by this Court to be misplaced because the untimely memorandum filed by the Federal Trade Commission in the Court of Appeals neither sought a rehearing nor an amendment of the previous judgment in respect to the one matter controverted in the Court of Appeals and decided by the Court of Appeals in the first judgment. The second proposition was held inapplicable because the later judgment entered by the Court of Appeals reiterated, without change, everything which had been decided in the earlier judgment on the one controverted matter. Here, on the other hand, the motion for rehearing was timely filed; it was directed specifically to the matter now in contro-

versy in this Court; it was argued orally before the court; it was fully considered by the court on its merits and disposed of by a supplemental opinion; and the petition for writ of certiorari is directed toward precisely the same judgment as to which the motion for rehearing was denied.

The petition for a writ of certiorari was timely filed.

Respectfully submitted.

OSCAR H. DAVIS,
Acting Solicitor General.

JULY 1953.

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SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

SIMON E. SOBELOFF,
Solicitor General,
Department of Justice,
Washington 25, D. C.

In the Supreme Court of the United States

OCTOBER TERM, 1954

THE UNITED STATES OF AMERICA, PETITIONER

v.

OLYMPIC RADIO AND TELEVISION, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

In its petition for certiorari the United States noted (Pet. 3-5) that the decision of the Court of Claims in this case is in direct conflict with that of the Tax Court in *Lewyt Corp.* v. *Commissioner*, 18 T. C. 1245, and that the Court of Claims expressly recognized the conflict (R. 14). On July 14, 1954, the Court of Appeals for the Second Circuit affirmed the decision of the Tax Court in the *Lewyt* case. The Second Circuit took notice of the contrary decision of the Court of Claims in the instant case, but declined to follow it. Its opinion,

which is set out in full in the Appendix, *infra*, states (p. 21):

> Finally, on this point the taxpayer gives us the decision of the Court of Claims in *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109 (1952), *re-hearing denied* 110 F. Supp. 600 (1953), which squarely upholds the position of the taxpayer as to the meaning of "paid or accrued" in § 122(d)(6). We have given careful and respectful consideration to the two opinions of the majority in that case, which were based largely on the same considerations urged upon us by the taxpayer here, and find ourselves unable to agree with the Court of Claims.

On August 24, 1954, the Court of Appeals for the Second Circuit denied *per curiam*, without opinion, a petition for rehearing in the *Lewyt* case.

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.

SEPTEMBER, 1954.

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 184—October Term, 1953.

Argued April 15, 1954 Decided July 14, 1954
Docket No. 22871

LEWYT CORPORATION (Now known as Lewyt Manufacturing Corporation), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Before: CLARK, HINCKS and HARLAN, CIRCUIT JUDGES

Petition to review a decision of the Tax Court determining a deficiency in petitioner's income taxes for the taxable year ended September 30, 1944, and a deficiency in excess profits taxes for the taxable year ended September 30, 1945. Tietjens, *Judge*. Affirmed.

FREIDIN & LITTAUER, New York City (Eugene Meacham, Fred R. Tansill and Seymour Sheriff, of Counsel) *for the petitioner.*

H. Brian Holland, Assistant Attorney General (Ellis N. Slack, Lee A. Jackson, and I. Henry Kutz, Special Assistants to the Attorney General, of Counsel) *for the respondent.*

HARLAN, *Circuit Judge:*

We are asked to review a decision of the Tax Court determining a deficiency of $7,129.21 in peti-

tioner's income tax for the taxable year ended September 30, 1944, and a deficiency of $446,557.19 in excess profits tax for the taxable year ended September 30, 1945. The taxpayer is a New York corporation engaged in the manufacture of vacuum cleaners and electronic devices. For tax purposes it used a fiscal year ending each September 30 and reported on an accrual basis. Each fiscal year referred to in this opinion will be designated simply by the calendar year in which it ended.

In the two years in question § 23(s) of the Internal Revenue Code [26 U. S. C. A. § 23(s)] provided that in computing net income there should be allowed as a deduction (from gross income) the "net operating loss deduction" provided in § 122 (26 U. S. C. A. §122). Section 122(a) defines "net operating loss" as "the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)." We are not concerned here with any of the provisions of subsection (d) except that contained in (d) (6) which permits the deduction of taxes "imposed by Subchapter E of Chapter 2 [excess profits taxes] paid or accrued within the taxable year," subject to certain rules not presently relevant. If a taxpayer has a net operating loss for a given taxable year, § 122(b)(1) and (2) and § 122(c) [1] provide that it may be ap-

[1] "§ 122. Net operating loss deduction

* * *

(b) Amount of carry-back and carry-over.

(1) Net operating loss carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating

plied, in accordance with prescribed specifications, as a deduction in computing net income for the two preceding taxable years (called a "carry-back") and for the two succeeding taxable years (called a "carry-over"), the starting point being with the second preceding taxable year, and any excess

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loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) Net operating loss carry-over. If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess,, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(c) Amount of net operating loss deduction. The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and

being carried successively, until exhausted, into the subsequent years ending with the taxable year secondly succeeding the year in which the net operating loss occurred.

The taxpayer had net operating losses in each of the years 1946 and 1947, and the dispute we have before us relates primarily to (a) the proper computation of such losses for each of those years, and (b) the application of such losses to the years 1944 and 1945, in each of which the taxpayer had substantial taxable net income.

We come first to the questions relating to the year 1945 in respect of which the Tax Court sustained the determination of the Commissioner that there was a deficiency in excess profits taxes of more than $460,000.

The Commissioner determined that in 1947 the taxpayer had a net operating loss of $786,383.25, which he allowed as a "carry-back" deduction to 1945. The taxpayer claimed additional "carry-backs" to 1945 aggregating $1,381,402.33 by reason of (a) the remittance to the Collector in 1947 of $300,008.87 in respect of excess profits taxes for the years 1943, 1944, and 1945 which, it is asserted, should have been added to the net operating loss for 1947; (b) the remittance to the Collector in 1947 of $55,949.04 interest on the foregoing amount

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(4) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(e)) * * *"

and on some $12,000 of additional income taxes for 1943, which, it is claimed, should also have been added to the 1947 net operating loss; and (c) the failure to allow any portion of the net operating loss for 1946, claimed to be $1,025,444.42, as a "carry-back" to 1945. Each of these claims was denied by the Commissioner, who was sustained by the Tax Court. The taxpayer also contends that the Tax Court erred in failing to credit on the asserted excess profits tax deficiency for 1945 the sum of $108,437.36, which the taxpayer remitted to the Commissioner in 1947 in respect of 1945 excess profits taxes (this amount being part of the $300,008.87 referred to above).

1. *1947 Principal Remittances*

These remittances aggregating $300,008.87 were made under the following circumstances:

Prior to 1947, a dispute arose between the taxpayer and the Collector as to the taxpayer's 1943 tax liability. On August 30, 1946, the Collector issued a statutory notice asserting income and excess profits tax deficiencies for 1943 in the amount of $7,757.49 and $194,992.51, respectively. The taxpayer objected to these deficiencies and took the matter to the Tax Court. Meanwhile, settlement negotiations were opened. On September 29, 1947, the taxpayer's auditor, believing that a formula for settlement had been reached, recomputed the tax liability for 1943 and sent the Collector a check for $190,002.16, of which $154,473.30 represented additional taxes for 1943 computed in accordance

with the supposed settlement formula, and $35,528.86 the interest on such sum from December 15, 1943. The Collector deposited this check on September 29, 1947 in his "Suspense Account."

Notwithstanding this transaction, settlement conferences continued down to October 30, 1947, when they were broken off, the Head of the Technical Staff of the New York Division advising the Division Counsel on November 6, 1947 that a satisfactory settlement had not been reached and that defense of the case should proceed. However, negotiations were evidently resumed, for on February 24, 1948 a settlement stipulation was filed settling, among other things, the asserted 1943 excess profits tax deficiency for the sum of $140,147.87 which was $1,470.26 less than the amount attributable to excess profit taxes ($141,618.13) in the taxpayer's remittance of September 29, 1947.

On September 29, 1947, the taxpayer also forwarded to the Collector a check for $178,810.92, stated in the letter of transmittal to represent additional taxes of $49,953.38 for 1944, with interest in the amount of $8,492.07, and of $108,437.36 for 1945, with interest in the amount of $11,928.11. This remittance was predicated on a Revenue Agent's examination of the taxpayer's books for 1944 and 1945 (as well as 1946 and 1947), and a computation by the taxpayer's auditor applying in respect of excess profits taxes the same supposed settlement formula as underlay the taxpayer's remittance relating to 1943 excess profits taxes. Although no deficiency notice had been issued, and no settlement

negotiations had been begun as to 1944 and 1945 taxes, the factors giving rise to the alleged excess profits tax deficiency for 1943 were deemed equally applicable to 1944 and 1945. The Collector also deposited this second remittance in his "Suspense Account."

The taxpayer charged on its books to earned surplus the principal amounts of these two remittances as tax payments, *viz:* $154,473.30 for 1943, $49,953.38 for 1944, and $108,437.36 for 1945. Of the first item, $12,855.17 represented income taxes (with which we are not concerned here) and the balance, aggregating $30,008.87, represented excess profits taxes. The interest payments on these three items were charged to 1947 expense on the taxpayer's books, *viz:* $35,528.86 (1943), $8,492.07 (1944) and $11,928.11 (1945), or a total of $55,949.04.

The taxpayer's position that the $300,008.87 of remittances in respect of excess profits taxes should have been allowed as a deduction in computing the net operating loss for 1947 (thereby increasing the "carry-back" to 1945) rests upon § 122(d)(6). As heretofore noted, this section gives a deduction for "the amount" of excess profits taxes "imposed" which were "paid or accrued within the taxable year."

Preliminarily it should be said that while there is an issue relating to the computation of the 1946 net operating loss (which we discuss later) as to the correctness of the Tax Court's holding that in the case of an accrual taxpayer, as this taxpayer was,

this section permits only the deduction of excess profits taxes which *accrued* within the taxable year, for the point now under discussion the taxpayer accepts the decision of the Tax Court in this respect as being correct. It can afford to do so since it is clear that none of these excess profits taxes had accrued prior to 1947 because they were in dispute—see *Dixie Pine Products Co.* v. *Comm'r*, 320 U. S. 516 (1944)—and whether they accrued in 1947 depends upon whether they can be considered as "paid" in that year despite the fact that the dispute over them was not settled until at least 1948. See *Chestnut Securities Co.* v. *United States*, 62 F. Supp. 574 (Ct. Cls. 1945), and *Lehigh Valley Railroad* v. *Comm'r*, 12 T. C. 977 (1949). So the sole question with which we are now concerned is whether these 1947 remittances constituted taxes "paid" within the taxable year, that is 1947, within the meaning of § 122(d)(6). We think they did not.

A remittance made in respect of an asserted or putative tax liability in no proper sense constitutes a tax "payment" except to the extent that it is effective to discharge such liability in whole or in part. That in turn depends upon the agreement of the taxpayer and the Commissioner or his representatives, acting within their powers, or upon whether the taxing authorities have a duty under the particular circumstances involved to accept the remittance as a payment of the tax in full or *pro tanto*.

Here there was admittedly no agreement in this respect between the taxpayer and the taxing authorities in 1947, and the only question is whether the Collector was, in the setting of these remittances, under a duty to accept them as "payments" *pro tanto* of the asserted or putative tax liabilities against Lewyt. We think he had no such duty. The taxpayer's 1943 tax liability was still in dispute on September 29, 1947, when these remittances were made. Settlement negotiations continued into 1948, and no settlement was reached until February 1948. Meanwhile the taxpayer's proceedings in the Tax Court remained alive. With respect to 1944 and 1945 taxes, the Revenue Agent had commenced his examination of the taxpayer's 1944 and 1945 returns, and it was clear that the same issues giving rise to the Commissioner's deficiency notice of August 30, 1946 as regards 1943 taxes were also involved for 1944 and 1945. So far as the record discloses, deficiency notices for 1944 and 1945 were not issued until February 16, 1950; and, in any event, it is clear that the controversy as to those issues present in the 1943 dispute, which were also applicable to 1944 and 1945, was active until at least 1948.

In these circumstances, we think that the action of the Collector in placing these 1947 remittances in his "Suspense Account" to abide the event of the disposition of these disputes was quite proper. The taxpayer was not entitled to have these remittances treated as a satisfaction of its tax liabilities in whole or in part, and at the same time

continue to contest such liabilities, or at best leave the Collector with an ambiguous situation on his hands.

Rosenman v. *United States*, 323 U. S. 658 (1945), while not reaching the precise point we have here, does support our view of the matter. In that case the Supreme Court held that the period of limitation on refund claims provided in § 910, I. R. C., requiring such claims to be presented within three years "after the payment of such tax," commenced to run from the time the Commissioner assessed the tax rather than from an earlier time when the taxpayer had made a general payment on account of estimated estate taxes. Stating that "payment" of a tax as contemplated by § 910, I. R. C., "plainly presupposes challenged action by the taxing officials" in response to which a remittance is made, the Court under the facts of that case held that no "tax payment" occurred until there had been an assessment followed by its satisfaction in part out of moneys already deposited with the Collector and in part by additional amounts paid by the taxpayer in response to such assessment, since it was only at that point that interest began to run against the Government on any amount in excess of that ultimately found due as the tax. While we do not read *Rosenman* to foreclose treating as a tax payment any remittance made prior to assessment, we do think that it supports the view that a remittance which does not *satisfy* an asserted tax liability should not be treated as the "payment" of a tax. Satisfaction may, as in *Rosenman*, follow from

payment of a tax assessed, for such a payment extinguishes the asserted liability, even though the taxpayer is left with an independent claim for refund which survives the discharge of the assessment. Or it may follow from the payment of an asserted liability in advance of assessment, as appears to be contemplated by § 56(d), I. R. C., and 26 C. F. R. 601.13(b)(2),[2] *if*, as is expressly provided in the latter and by necessary implication in the former, the payment is accompanied by the taxpayer's acquiescence in the proposed deficiency. The same holds true as to § 271(a)(1)(B), requiring that amounts "collected without assessment" be excluded from the computation of a deficiency, for here again acquiescence by the taxpayer in such collections as constituting satisfaction of part of his tax liability is a condition necessarily to be implied. In short, there can be no payment without satisfaction whether pursuant to or apart from an assessment. Here the taxpayer was tendering its check with one hand, and contesting its liability to pay with the other. Its Tax Court proceedings as to the 1943 deficiency still stood, and that avenue was still open to it as to 1944 and 1945 taxes.

The taxpayer is quite mistaken, we believe, in reading *Roseman* as standing for the proposition that the 1947 remittances should be treated as tax payments *ab initio* to the extent of the taxes ultimately found owing because they were effective

[2] See also informal ruling of Internal Revenue Bureau contained in Prentice-Hall Federal Tax Service, 1950, par. 76,331

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BRIEF FOR THE UNITED STATES

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
RALPH S. SPRITZER,
LEE A. JACKSON,
I. HENRY KUTZ,
Special Assistants to the Attorney General,
Department of Justice,
Washington 25, D. C.

to stop the running of interest against the taxpayer. The initial *Rosenman* payment was found not to be a tax payment despite the fact that the Court recognized that it stopped penalties and, as the Government conceded, interest *against the taxpayer*. It was found not to be a tax payment because it gave rise to no interest claim *against the Government*. The situation here is no different. Nor do we find such decisions as *Hanley* v. *United States*, 63 F. Supp. 73 (Ct. Cls. 1945), inconsistent with our conclusion, for there the taxpayer did not negative "payment" by simultaneous contest. Cf. *Murphy* v. *United States*, 78 F. Supp. 236 (S. D. Calif. 1948).

We hold that the 1947 remittances did not constitute "payment" of the taxpayer's 1943, 1944 and 1945 tax liabilities. They were no more than deposits "made in the nature of a cash bond for the payment of taxes thereafter found to be due." *Rosenman*, at p. 662.

The taxpayer also argues that the Tax Court's order entered on the 1948 stipulation settling the 1943 excess profits tax liability binds the Government by way of collateral estoppel from now asserting that the 1947 remittance in respect of the 1943 tax was not a payment of the tax. We need not dwell on this contention. It seems clear (although the pleadings are not before us) that the settlement was concerned only with the *fact* of payment and not with its *date*. The item in the stipulation "Tax paid: September 29, 1947 (3rd NY)" does not persuade us that the question we now have before us was really at issue in the Tax Court.

2. *1947 Interest Payments*

For the same reasons the taxpayer's contention as to the deductibility of the 1947 interest payments in respect of 1943, 1944 and 1945 taxes must also fail.

3. *1946 Net Operating Loss*

The taxpayer challenges the determination of the Commissioner and the Tax Court as to the amount of the 1946 net operating loss.

As determined below, the net operating loss for 1946 was $164,326.38. The taxpayer argues that it should have been increased by $861,118.04, being the amount of the excess profits taxes which it paid in that year in respect of 1945.

This requires us to interpret the phrase "paid or accrued" in § 122(d)(6) permitting the deduction of excess profits taxes "paid or accrued within the taxable year" in the computation of the net operating loss under § 122(a). As already noted, it was unnecessary to reach this problem with respect to the 1947 net operating loss. The Tax Court held that "paid or accrued" meant that a *cash* taxpayer was entitled to deduct only excess profits taxes "paid," and an *accrual* taxpayer only those "accrued," within the taxable year, and that since Lewyt was an accrual taxpayer this sum of $861,118.04 could only be reckoned in Lewyt's tax computations for 1945. We think the Tax Court was right.

We start with the statute itself. Section 48(c), I. R. C., 26 U. S. C. A. § 48, provides that "when

used in this chapter" (that is Chapter 1 entitled "Income Tax") "the terms * * * 'paid or accrued' shall be construed *according to the method of accounting upon the basis of which the net income is computed under this Part* [IV "Accounting Periods and Methods of Accounting"].[3] See also T. R. 29.43-1. Section 43, I. R. C., 26 U. S. C. A. §43, captioned "Period for which deductions and credits taken," states: "The deductions and credits * * * provided for in this chapter [1] shall be taken for the taxable year in which 'paid or accrued' * * * dependent upon the method of accounting upon the basis of which net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

The taxpayer makes a number of arguments to avoid what we think to be the plain effect of these provisions. We consider first its argument based on legislative history. Section 202(a) of the Revenue Act of 1941 amended §23(c) of the Internal Revenue Code to permit deduction of Chapter 2E excess profits taxes "paid or accrued within the taxable year" in computing net income, subject to certain rules provided in §23(c)(2), one of which, "A," stated: "The deduction shall be limited to the tax *imposed* for the taxable year, but any portion of such tax paid *after* the taxable year shall be considered as having been paid *within* the taxable year * * *" The taxpayer here points out, and

[3] All italics in this opinion have been supplied.

we think correctly, that this last quoted provision in effect placed cash and accrual taxpayers substantially on an *accrual* basis so far as the excess profits tax deduction was concerned. Then came the Revenue Act of 1942 which by §105(c) eliminated Chapter 2E excess profits taxes as a deduction in computing net income, but added, by §105 (c)(3)(C), a new Section, §122(d)(6), permitting the deduction of such excess profits taxes from gross income in computing the net operating loss, and net operating loss "carry-backs" and "carry-overs," subject to rules which were the same as those presently contained in §122(d)(6).

Pointing out that these rules are substantially the same as those formerly contained in §23(c) (2) as amended by the Revenue Act of 1941, except that rule "A" of that section, quoted above, was omitted, the taxpayer argues that one of two inferences should be drawn—either that the Congressional intent was that the basis of deductibility of excess profits taxes should follow the taxpayer's method of accounting, *i.e.*, cash or accrual, or that in this respect the Act gave a taxpayer, whether cash or accrual, an election to deduct such taxes if either paid or accrued. It is urged that the latter inference is the more compelling, it being argued, as we shall see in a moment, that to draw the first inference would attribute to Congress an intention to "discriminate" between cash and accrual taxpayers, in that an accrual taxpayer, absent such election, would rarely be able to take an excess profits deduction in a "loss" year.

We think that without more the arguments for and against these opposing inferences would at best present a stand-off. But we need not pause to examine them further, for here we have the explicit direction of §43 that this deduction "shall be taken for the taxable year in which 'paid or accrued' * * * *dependent upon the method of accounting upon the basis of which net income is computed*, unless in order to reflect the income the deductions * * * should be taken as of a different period." Certainly the exception would have no application in this instance, and it appears not to be contended to the contrary.

Next, we are referred to *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (D. C. Cir.), *cert. denied* 325 U. S. 881 (1945), and a line of cases following it, *Birmingham* v. *Loetscher Co.*, 188 F. 2d 78 (8th Cir. 1951); *Aramo-Stiftung* v. *Comm'r*, 172 F. 2d 896 (2d Cir. 1949); and *Wm. J. Lemp Brewing Co.* v. *Comm'r*, 18 T. C. 586 (1952), holding that the provisions of former §356, I. R. C., now §505(a)(1), I. R. C., 26 U. S. C. A. §505, permitting the deduction of excess profits taxes "paid or accrued during the taxable year" in computing the surtax upon the undistributed net income of personal holding companies under §500, I. R. C., 26 U.S.C.A. §500, gives a taxpayer, whether cash or accrual, the option of taking this deduction on either basis. The ground of these decisions, as exemplified by *Clarion*, is that the provisions of §48(c) in Chapter 1 of the Internal Revenue Code defining "paid or accrued" in terms of a taxpayer's method of re-

porting for the purpose of computing *net income* under that Chapter, have no application to the meaning of §505(a)(1) permitting deduction of excess profits taxes for the purpose of computing the *undistributed income* tax on personal holding companies under Chapter 2. "But, obviously, this definition [48(c)] was intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject matter of what, for the purposes of the newly added provision in relation to personal holding companies is taxable as *undistributed* income." *Clarion*, at p. 675. Stated otherwise, Chapter 2 contains no provisions comparable to §48(c) and §43 of Chapter 1 defining the phrase "paid or accrued."

The *Clarion* and the other cases cited are inapplicable to the one before us. Here the meaning of "paid or accrued" in §122(d)(6) is directly involved in the computation of *net income*, for §23(s) allows as a deduction in "computing net income" under §23 "the net operating loss deduction computed under Section 122." In addition, to the extent that the meaning of "paid or accrued" is involved in the computation of the net operating loss itself by application of the §122(d)(6) deduction, §43 specifically gives it the same meaning as §48(c) requires in connection with the computation of net income.

The third contention which the taxpayer presses upon us is that to construe §122(d)(6) as we do discriminates against the accrual taxpayer. The argument is that in the nature of things it is usually

impossible for a taxpayer to incur in the same year both an excess profits tax liability and a net operating loss. Therefore, it is said, an *accrual* taxpayer in most cases will be unable to get the benefit of the §122(d)(6) adjustment in calculating his net income, while a *cash* taxpayer normally will. Take this hypothetical situation as illustrative of the taxpayer's point. A corporation had high profit years in 1942 and 1943 and incurred a $1,000,000 excess profits tax liability in the latter year, which it paid in 1944. In 1944 it had a net operating loss of $500,000, without regard to any §122(d)(6) adjustment. If an *accrual* taxpayer, the corporation would not be able to add its excess profits taxes for 1943 to its net operating loss for 1944; if a *cash* taxpayer, it would; and this in turn would mean that the cash taxpayer's net operating loss "carry-back" to 1942 and 1943 under §122(b)(1) would be increased by $1,000,000, whereas the accrual taxpayer's "carry-back" would remain at $500,000.

We may conceive of situations where the accrual taxpayer is not put at this disadvantage with the cash taxpayer. One such is a situation where, as in the case of this taxpayer's 1943 excess profits taxes, accrual of the excess profits tax liability has been postponed because of a dispute concerning it, and the time of payment and accrual therefore coincide. See *Robert Reis & Co.* v. *Comm'r*, 20 T. C. 294 (1953). Nevertheless, we would not be candid if we failed to recognize the force of what the taxpayer argues here. But however sympathetic one may be to this predicament of an accrual taxpayer—

a phenomenon by no means unique under the tax laws—we would not be justified in ignoring the plain mandate of the statute.

Finally, on this point the taxpayer gives us the decision of the Court of Claims in *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109 (1952), *re-hearing denied* 110 F. Supp. 600 (1953), which squarely upholds the position of the taxpayer as to the meaning of "paid or accrued" in §122(d)(6). We have given careful and respectful consideration to the two opinions of the majority in that case, which were based largely on the same considerations urged upon us by the taxpayer here, and find ourselves unable to agree with the Court of Claims.

4. *1946 Net Operating Loss "Carry-Back"*

Now we come to the issue involving the "carry-back" of the 1946 net operating loss to 1944 and 1945. As previously noted, §122(b)(1) requires that such loss be applied first to the year 1944 and the excess, if any, to 1945. That excess is the amount by which the 1946 operating loss exceeds the income for 1944 "computed (A) with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6) [of §122] *and* (B) by determining the net operating loss *deduction* for such second preceding taxable year [1944] without regard to such [1946] net operating loss." §122(b)(1) and §122(c).

In terms of the present case, the situation is this: The taxpayer's 1944 income, as to which there is

no dispute, was $584,866.81, *without regard* to any §122(d)(6) adjustment or the 1946 net operating loss deduction under §23(s). There was no net operating loss for 1944. The net operating loss for 1946, as determined by the Commissioner, was $164,326.38, and we have already disposed of the contention that it should have been increased by $861,118.04, the amount of the excess profits taxes paid by the taxpayer in 1946 in respect of 1945.

The taxpayer contends that in computing the amount of the 1946 net operating loss ($164,326.38) which is to be carried back to 1945, there should first be offset against 1944 net income ($584,866.81) either (a) the sum of $759,916.50, being the amount of the 1943 excess profits taxes reflected in the taxpayer's return for that year and *paid* by it in 1944, or (b) the sum of $625,561.59, being the amount of the 1944 excess profits taxes as reflected in the taxpayer's return for 1944, and which it claims *accrued* in 1944. Since under (a) the 1943 excess profits taxes *paid* in 1944 ($759,916.50) exceeded by $175,049.69 the unadjusted net income for 1944 ($584,866.81) and under (b) the 1944 excess profits taxes *accrued* for that year ($625,561.59) exceeded by $40,694.78 such net income for 1944 ($584,866.81), the taxpayer claims that the entire 1946 net operating loss ($164,326.38) constitutes a "carry-back" to 1945. We cannot agree.

What we have already held as to the meaning of "paid or accrued" in §122(d)(6) in connection with the computation of the 1946 net operating loss equally applies to the §122(d)(6) adjustment to

1944 net income, and disposes of the contention that for this purpose the taxpayer was entitled to deduct from such income the 1943 excess profits taxes *paid* in 1944.

The other contention must also fail. The excess profits taxes ultimately found by the Commissioner to be due in respect of the year 1944 were $280,540.33, and not $625,561.59, as originally reported in the taxpayer's 1944 return, and we think it was this figure rather than the uncorrected figure which represented the measure of the §122(d)(6) adjustment to 1944 net income. Section 122(d)(6) allows the deduction of "the amount" of excess profits taxes "imposed" and (in the case of an accrual taxpayer) "accrued within the taxable year." The tax which was "imposed" for 1944 was $280,540.33, and that in our opinion was "the amount" of the tax which "accrued" in 1944 for purposes of this adjustment. True, it has been held that when all the events necessary to determine the amount of a tax have occurred within a taxable year, the tax as reported in that year constitutes the tax "accrued" despite the occurrence of later events which change the amount of the tax ultimately found due. See *United States* v. *Detroit-Moulding Corp.*, 56 F. Supp. 754 (E. D. Mich. 1944). But if we are to follow this view we should also take the *income* as originally reported in the 1944 return, *viz.*, $827,852.99 instead of $584,866.81 as finally determined by the Commissioner. What the taxpayer is seeking to do is to have the benefit of both the *smaller* 1944 income as finally determined ($584,-

866.81) and the *larger* excess profits tax ($625,561.59), based upon the income as originally reported. The taxpayer must match either the *returned* income ($827,852.99) against the *returned* excess profits tax based thereon ($625,561.59), or the *determined* income ($584,866.81) against the determined excess profits tax ($280,540.33). It cannot have it both ways at the same time by matching *determined* income against *returned* excess profits taxes. And we think it is *determined* income and excess profits taxes that represent the proper §122(d)(6) adjustment, since the manifest purpose of the "carry-back" and "carry-over" provisions of the statute, §122(b)(1), (2) is that the incidence of this kind of taxation upon a business enterprise shall in effect be looked at from the vantage point of a five year period, that is the current taxable year plus two "carry-back" and two "carry-over" taxable years.

In light of this wearisome discussion, we think that the correct situation as to the 1946 "carry-back" was this: The taxpayer's 1944 net income, before the §122(d)(6) and §23(s) adjustments, was $584,866.81. The excess profits taxes which accrued for 1944 were $280,540.33. After the §122(d)(6) adjustment ($584,866.81 *minus* $280,540.33), the balance of 1944 income was $304,326.48. Since this was greater than the net operating loss for 1946 ($164,326.38), this resulted, as the Commissioner and Tax Court determined, in there being nothing left from the 1946 net operating loss to "carry back" to 1945. It likewise resulted in there being taxable income for 1944.

5. Computation of 1945 Excess Profits Tax Deficiency

In computing the excess profits tax deficiency for 1945, the Commissioner apparently gave no credit for the $108,437.36 remitted by the taxpayer on September 29, 1947. The taxpayer asserts this was an amount "collected without assessment" which under §271(a)(1)(B) the Commissioner was required to take into account in computing the 1945 deficiency. See *McConkey* v. *Comm'r*, 199 F. 2d 892 (4th Cir. 1952), *cert. denied* 345 U. S. 924 (1953); *Bendheim* v. *Comm'r*, 2d Cir., decided June 9, 1954.

For the reasons already discussed, we think that this would be so only if the remittance were made under circumstances which would constitute it a satisfaction of a tax liability in whole or in part. In the *McConkey* and *Bendheim* cases, *supra*, the taxpayers made remittances similar to that now under consideration. Each of those remittances was deposited in the Collector's "Suspense Account" and stood, under the authority of the *Rosenman* case, as "a cash bond for the payment of taxes thereafter found to be due," or, in effect, as a continuing offer by the taxpayer to the Collector that he apply the amount to the discharge of a tax liability in whole or in part. And in each of those cases the Collector, after these deposits with their implicit offers had been made, stated a proposed deficiency not in excess of the deposit, thereby indicating unequivocally an acceptance of the taxpayer's offer. Accordingly, the amounts became "col-

lected without assessment" within the meaning of §271(a)(1)(B), and the taxpayer's sole remedy remaining was an independent suit for refund.

Here, however, the Collector did not accept, explicitly or implicitly, the taxpayer's remittance as a discharge of its tax liability, in whole or in part, nor could he be forced to do so while that liability was still in dispute. Indeed, no deficiency had yet been proposed in 1947. But in 1948 the Revenue Agent proposed a deficiency in excess of the taxpayer's remittance, as to which the Commissioner issued his deficiency notice on February 16, 1950, and which the taxpayer was free to, and did, contest; and certainly the Commissioner for his part was not required to circumscribe his position in the ensuing litigation in the Tax Court by making application of such remittance to the asserted tax liability. In other words, until the Commissioner, with unequivocal authority of the taxpayer, applied or was required to apply the $108,437.36 remittance as a satisfaction, in whole or in part, of the asserted tax liability, this remittance did not constitute an amount "collected without assessment" within the meaning of §271, but continued as no more than a deposit voluntarily made by the taxpayer.

Affirmed.

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 10

THE UNITED STATES, PETITIONER

v.

OLYMPIC RADIO AND TELEVISION, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The original opinion of the Court of Claims and the dissenting opinion (R. 10-14) are reported in 108 F. Supp. 109. The opinion on rehearing (R. 16-19) is reported in 110 F. Supp. 600.

JURISDICTION

The judgment of the Court of Claims was entered November 4, 1952. (R. 10, 14.) On December 3, 1952, the Government filed a motion for rehearing (R. 14) which was denied on March 3, 1953 (R. 16).

The petition for a writ of certiorari was filed on May 29, 1953, and was granted on October 14, 1954. (R. 21.) The jurisdiction of this Court rests on 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

Whether, under Section 122(d)(6) of the Internal Revenue Code, a taxpayer on the accrual basis can, in computing its net operating loss for one year, deduct the amount of excess profits taxes which were paid in that year but had accrued in an earlier year.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions (Sections 23(c)(1) and (s), 41, 43, 48(c), 122, 710(a)(1) and (b), 711(a)(1)(J) and (2)(L) of the Internal Revenue Code of 1939) [1] and Treasury Regulations (Treasury Regulations 111, Sections 29.41-1, 29.41-2, 29.43-1, 29.122-1, and 29.122-2) are set forth in Appendix A, *infra*, pp. 36-53.

STATEMENT

This case was submitted to the Court of Claims on motions for summary judgments filed by both parties, together with supporting affidavits. The facts, which are not in dispute, are as follows:

Taxpayer, a New York corporation, keeps its accounts and files its income and excess profits

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[1] All references to the "Internal Revenue Code" or "Code" are to the "Internal Revenue Code of 1939" unless otherwise expressly noted.

tax returns on the accrual basis, using the calendar year as its accounting period. (R. 1.) It seeks to recover in this action the sum of $148,841.72, representing a portion of the excess profits tax for the year 1944 which it paid in 1945 in the total amount of $623,454.42. (R. 2, 3, 11.)

Taxpayer's income tax return for the year 1946 reflected a net operating loss of $324,844.23 which, upon audit by the Commissioner and with taxpayer's acquiescence, was reduced to $310,872.60. (R. 2.) The net operating loss of $310,872.60 was carried back and set off against taxpayer's excess profits net income for 1944, as permitted by law, and its excess profits tax for 1944 was adjusted in conformity with the resulting reduction in income. (R. 2, 5, 11.) This adjustment is not in controversy.

In the year 1946 taxpayer paid $263,272.80 on account of a reported excess profits tax liability of $346,643.22 for the year 1945. (R. 2, 9.) It contends that under Section 122(d)(6) of the Internal Revenue Code (Appendix A, *infra,* p. 42) the $263,272.80 so paid in 1946 should have been added to the admitted net operating loss of $310,872.60 for that year, and that the sum of these two figures ($574,145.40), instead of the second figure alone, should have been carried back as a net operating loss from 1946 to 1944 (R. 5, 11). If this had been done, the Court of Claims found, it would have further reduced the 1944 excess profits tax liability by $148,841.72, which is the amount claimed in this suit. (R. 11-12.)

Although, as stated above, taxpayer originally reported an excess profits tax liability of $346,643.22 for the year 1945, of which $263,272.80 was paid in 1946, the entire amount of the reported tax was subsequently refunded or credited to taxpayer as a result of a net operating loss carryback from 1947 to 1945. (R. 10.)

The Court of Claims sustained taxpayer's contention and held (Madden, J., with whom Jones, C. J., concurred, dissenting) that, in computing its net operating loss for 1946, taxpayer was entitled to include therein the amount of excess profits tax paid in 1946 on account of the liability shown on its return for the year 1945. (R. 10-14.) Judgment was entered in favor of taxpayer in the amount of $148,841.72 with interest. (R. 14.) On rehearing, the court adhered to its original decision. (R. 16-19.)

SUMMARY OF ARGUMENT

I

A. The applicable statutory definitions require the conclusion that Congress used the alternative verbs "paid or accrued" in Section 122(d)(6) to distinguish between taxpayers on a cash basis and taxpayers on an accrual basis (i. e., "paid," if on cash basis, and "accrued," if on accrual basis), and that a taxpayer has no option to take deductions on a basis inconsistent with the method of accounting which it employs. Thus, Section 48(e) explicitly directs that, when used in "this chapter" (Chapter 1, which includes Section 122), the

"terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed. . ." The same principle is declared in the relevant accounting rules prescribed by the Code (Sections 41, 43) and in pertinent Treasury Regulations. As stated by the Second Circuit in *Lewyt Corp.* v. *Commissioner,* No. 417, there can be no "ignoring the plain mandate of the statute" (215 F. 2d 518, 526). There is particularly strong reason when a taxpayer is seeking the advantage of a deduction—a matter not of right but of legislative grace—that it be required to bring itself clearly within the statute.

In keeping with the above provisions, the courts have held, in a wide variety of situations, that one reporting income on an accrual basis is bound by the rule which requires such a taxpayer to take deductions only in the year of accrual. It is also significant that taxpayer does not suggest a recomputation of the whole of its operations on a cash basis consistent with its claim for taking subsection (d)(6) deductions on a cash basis.

Taxpayer is not aided by *Commissioner* v. *Clarion Oil Co.,* 148 F. 2d 671 (C.A. D.C.), and similar cases involving the imposition of a penalty surtax on the undistributed income of personal holding companies. Those cases hold that while the statutory definitions of "paid or accrued" in terms control the method of computing net income (see 148 F. 2d at 675), they need not be applied in determining the penalty tax on undistributed in-

come prescribed by subchapter A of chapter 2. The net operating loss deduction claimed in the instant case relates solely to the "computing [of] net income" (Section 23(s)) and, under the reasoning of *Clarion Oil*, the statutory definition of "paid or accrued" controls.

Taxpayer also urges a departure from the statutory definition on the ground that otherwise accrual basis taxpayers will get no substantial benefits from Section 122(d)(6). But there are situations in which excess profits taxes will "accrue" during a loss year and will cause or augment a net operating loss. See, *e.g., Robert Reis & Co.* v. *Commissioner*, 20 T.C. 294. And, in any event, the fact that cash basis taxpayers may as a practical matter derive more benefits from this provision than accrual basis taxpayers could not warrant a revision of the statute by the courts. Cf. *Crooks* v. *Harrelson*, 282 U.S. 55, 60.

B. Taxpayer asserts the right to augment its 1946 net operating loss by the amount of excess profits taxes, accrued in 1945, which it paid in 1946. Assuming, *arguendo*, contrary to our contention above, that the statute permits an accrual basis taxpayer to follow such a course, there is a further obstacle to the claimed deduction in the instant case. The amount paid in 1946 was subsequently refunded in full as a result of a carryback from 1947. Thus, no actual economic loss was suffered as a result of the 1946 payments and no net operating loss can be founded upon them. Section 122(d)(6) allows as a deduction the amount of excess profits taxes actually *imposed*

in a given taxable year. There were not two excess profits taxes imposed for 1945; there was only one, and that was in the amount as finally determined.

II

The language of Section 122(d)(6) had its antecedent in Section 23(c)(2) as amended by the Revenue Act of 1941. Examination of the earlier section in its entirety shows that when Congress wished to treat cash basis and accrual basis taxpayers similarly for purposes of a particular deduction, it did so explicitly. Rule "A" of Section 23(c)(2) provided:

> The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year; * * *

The failure to adopt a similar provision in Section 122(d)(6), added in 1942, supports the view that the words "paid or accrued", as there used, must be taken in their ordinary, statutory sense.

The specific Congressional purpose in adding Section 122(d)(6) is not unequivocally expressed in the legislative history. The underlying legislative policy can be gleaned, however, from the following:

(1) The language of the new subsection had its origin in Section 23(c)(2) as amended by the 1941 Act. In the framework of that Act, a taxpayer deducted its excess profits tax for purposes of computing its other corporate taxes (normal tax and

surtax). When this was altered by the 1942 Act, which authorized a different and larger deduction, and hence a new method of computing the normal tax and surtax, Section 23(c)(2), providing for deduction of excess profits tax, was repealed.

(2) The reappearance of this language in Section 122(d)(6), described as one of a "number of miscellaneous amendments" of a "technical" nature "made necessary by [the] change in base for corporate tax" and required "in order to make it all come out straight," hardly suggests that Congress contemplated a novel and far-reaching deduction of the kind which taxpayer urges—a deduction which would permit a corporation, whether on cash or accrual basis, to deduct all excess profits taxes, both paid and accrued within any taxable year, for purposes of determining its net operating loss.

Since it may be fairly stated that, whatever else was contemplated (or overlooked), there is no evidence of an express or implied intention to effect a drastic departure from familiar and accepted tax concepts, the legislative history, far from supporting the motion that (d)(6) should be construed to obliterate the statutory definition of "paid or accrued," emphasizes the wisdom of confining the amendment within the limits of its statutorily-defined terminology.

ARGUMENT

Section 23(s) of the Internal Revenue Code of 1939 provides that in computing net income there shall be allowed "the net operating loss deduction

computed under section 122" (Appendix A, *infra*, p. 36). The "net operating loss deduction" for a taxable year is based on the "net operating losses" for the two preceding and two succeeding years, which, subject to certain adjustments, become available as "carry-overs" and "carry-backs" to the taxable year.[2] We are here concerned with the amount of the "net operating loss" for the year 1946 which may be carried back to the year 1944. Section 122(a) of the Code defines the term "net operating loss" to mean "the excess of the deductions allowed by this chapter [Income Tax] over the gross income, with the exceptions, additions, and limitations provided in subsection (d)." (Appendix A, *infra*, p. 38.) Section 122(d)(6) provides that "There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 [Excess Profits Tax] paid or accrued within the taxable year." (Appendix A, *infra*, p. 42.)[3]

The years 1944 and 1945 were years of profit for taxpayer, and were followed by years of loss

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[2] Determination of the net operating loss under Section 122 (a) is the first of the three steps involved in computation of the net operating loss deduction. The second involves determination of the amount and extent to which the net operating loss may be utilized as a two-year carry-back or carry-over, as set out in Section 122(b) (Appendix A, *infra*, pp. 38-40). The third step is conversion of the aggregate of permissible carry-overs and carry-backs under Section 122(c) (Appendix A, *infra*, pp. 40-41) into the net operating loss deduction. *Reo Motors* v. *Commissioner*, 338 U.S. 442, 446-447; Treasury Regulations 111, Section 29.122-1 (Appendix A, *infra*, pp. 49-50).

[3] This provision is subject to certain rules not here relevant.

in 1946 and 1947. (Statement, *supra*, pp. 3-4.) The court below (two judges dissenting) held that although taxpayer admittedly maintained its books and records and filed its tax returns on the accrual basis of accounting, and although its 1945 excess profits tax accordingly *accrued* in 1945, taxpayer might nonetheless, under Section 122(d)(6), augment its net operating loss for 1946 by including the sum of $263,272.80 *paid* in 1946 on account of its excess profits tax liability for 1945. (R. 11-14.) In reaching this result, which is diametrically opposed to the holding of the Court of Appeals for the Second Circuit in the companion case of *Lewyt Corp.* v. *Commissioner*, No. 417, this Term (see 215 F. 2d 518, 523-526, affirming the unanimous decision of the full Tax Court, 18 T.C. 1245), the majority of the court of claims conceded that its decision "does violence to the letter of the Act" but was of the view that the result was in keeping with the purpose of Congress. (R. 13.)[4]

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[4] The majority below noted its disagreement and the minority its concurrence with the Tax Court's decision in the *Lewyt* case. (R. 14.) Since the decision below, the Tax Court has repeatedly expressed adherence to its decision in *Lewyt*. *Hunter Manufacturing Corp.* v. *Commissioner*, 21 T.C. 424, appeal pending (C.A. 3d); *Wheeler Insulated Wire Co.* v. *Commissioner*, 22 T.C. 380, appeal pending (C.A. 2d); *W. L. Maxson Corp.* v. *Commissioner*, decided January 26, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,021), supplemental opinion June 17, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,174), appeal pending (C.A. 2d); *Byrne Doors, Inc.* v. *Commissioner*, decided April 8, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,107), appeal pending (C.A. 6th).

It is the Government's position that in the light of the unambiguous provisions of the Internal Revenue Code, which are discussed in Point I, *infra*, it was not open to the court below to speculate concerning the possible purposes contemplated by Congress and to create opportunities for extensive deductions in circumstances where they are explicitly precluded by the statutory language. We shall urge additionally (Point II, *infra*) that the legislative history does not support the Court of Claims' position, but fairly indicates that Congress did not intend to change the meaning of "paid or accrued" explicitly defined in Chapter 1 of the Code.

I

The Explicit Mandate of the Statute Precludes Allowance of the Deduction for Which Taxpayer Contends

A. *Section 122(d)(6) denies an accrual basis taxpayer the right to deduct its excess profits tax in the year paid, if the tax accrued in another year.*

1. As stated above, Section 122(d)(6) permits deduction of the amount of excess profits tax "paid or accrued" in the taxable year. In our view, definitive provisions of the Internal Revenue Code, as well as implementing Treasury Regulations of long standing, require the conclusion that the alternative verbs "paid or accrued" serve to distinguish between taxpayers on a cash basis and taxpayers on an accrual basis (i.e., "paid," if on a cash basis, and "accrued," if on an accrual

basis) and do not provide the taxpayer an option to take deductions on a basis inconsistent with the method of accounting which it employs.

Section 41 (Appendix A, *infra*, p. 37) states the general rule that "net income shall be computed upon the basis of the taxpayer's annual accounting period * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer * * *."

Section 43, entitled "Period for Which Deductions and Credits Taken," provides (Appendix A, *infra*, pp. 37-38):

> The deductions and credits * * * provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Even more pointedly, Section 48(c) specifically provides (Appendix A, *infra*, p. 38) that, when used in "this chapter" (i.e., Chapter 1, entitled "Income Tax," which *includes* Section 122)—

> The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed * * *.[5]

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[5] This language has been substantially incorporated in income tax legislation commencing with the Revenue Act of 1918, c. 18, 40 Stat. 1057, Section 200.

Treasury Regulations 111, Section 29.41-2 (Appendix A, *infra*, pp. 47-48), referring to the definition in Section 48, declares that "A method of accounting will not * * * be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency." And Section 29.43-1(a) of the Regulations (Appendix A, *infra*, pp. 48-49) states:

> The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48(c).)

The above provisions are unequivocal. As stated by the court of appeals in the companion *Lewyt* case, No. 417, no argument rested on claim of hardship or legislative history which might be advanced in favor of a different result could justify "ignoring the plain mandate of the statute" (215 F. 2d at 526). To similar effect, see *Healy* v. *Commissioner*, 345 U.S. 278, 284-285; *Riley Co.* v. *Commissioner*, 311 U.S. 55, 59; *Crooks* v. *Harrelson*, 282 U.S. 55, 60; *United States* v. *Hill*, 248 U.S. 420. There is particularly strong reason when a taxpayer is seeking the advantage of a deduction—a matter not of right but of legislative grace—that it be required to bring itself clearly within the statutory provision. *Standard Paving Co.* v. *Commissioner*, 190 F. 2d 330, 333-334 (C.A. 10th); see also *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440; *White* v. *United States*, 305 U.S. 281, 292; *Deputy* v. *duPont*, 308 U.S. 488, 493.

2. In keeping with the statutory provisions discussed above, the courts have held, in a wide variety of situations, that one reporting income on an accrual basis may not evade the rule which requires such a taxpayer to take deductions in the year of accrual. See, *e.g.*, this Court's decisions in *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *Aluminum Castings Co.* v. *Routzahn*, 282 U.S. 92; *Niles Bement Pond Co.* v. *United States*, 281 U.S. 357; *United States* v. *Anderson*, 269 U.S. 422.[5a]

This Court's decision in *Reo Motors* v. *Commissioner*, 338 U.S. 442, is also closely in point, for there, as here, the taxpayer contended that language in Section 122 should bear a special interpretation different from the meaning accorded the same terms when used in other parts of Chapter 1. Rejecting this contention, the Court declared (p. 448):

> If, as petitioner contends, 1942 law governs although the loss occurred in 1941, it is difficult to see why the whole of its 1941 operations, and not merely the Reo Sales liquidation, should not be recomputed on the basis of the income and deduction provisions applicable in 1942. Petitioner does not suggest such a re-

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[5a] It is to be noted that Section 23, which provides (subsection (s)) that in computing net income there shall be allowed "the net operating loss deduction computed under section 122," uses the words "paid or incurred" and "paid or accrued" in various subsections (subsections (a)(1) and (2) (expenses); (b) (interest); (p) (pension trust); (z)(1) (taxes and interest paid to cooperative apartments)). And see especially Section 23 (c) (1), relating to deduction of taxes (Appendix A, *infra*, p. 36). There appear to be no cases arising under these subsections in which the courts have treated the quoted words in any sense other than that specified by

> computation, in spite of the fact that *the terms in which net operating loss is defined—"gross income" and "deductions allowed by this chapter"—are equally applicable in the computation of income taxes generally.* [Emphasis added.]

Nor does the taxpayer in the instant case suggest a recomputation of the tax for the whole of its operations for the pertinent years on a cash basis consistent with its claim for taking subsection (d)(6) deductions on a cash basis. Indeed, with the exception of the term "paid or accrued," taxpayer does not suggest that any of the numerous terms contained in Section 122 [6] should be interpreted differently for purposes of that section from the way in which they are understood throughout Chapter 1. [7] Yet, as observed above, it is explicitly directed in

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Section 48(c). See Mertens' comment (5 Mertens, *Law of Federal Income Taxation* (1953 ed.), Section 27.52), in relation to Section 23 (c)(1), that taxes are deductible "in the year of payment, and only in that year, by taxpayers on a cash basis and in the year of accrual, and only in that year, by taxpayers on an accrual basis."

[6] Examples of such terms, with which Section 122 is replete, are: "deductions allowed by this chapter," "gross income," "taxable year," "net income," "normal-tax net income," "discovery value," and in 122(d), in particular, "depletion," "percentage depletion," "interest paid or accrued," "capital assets," "operation of a trade or business," "consolidated return."

[7] It may be noted that the House Committee which originally recommended the enactment of Section 122 in the 1939 Act assumed that the definitions contained in Section 48 would be applicable to Section 122. Thus, referring to the term "taxable year" used in Section 122(b), the Committee stated (H. Rep. 855, 76th Cong., 1st Sess., p. 17 (1939-2 Cum. Bull., p. 517)):

> For the purpose of ascertaining the first, second, or third preceding taxable year, a fractional part of a year which

Section 48(c) that the term " 'paid or accrued' shall be construed" according to taxpayer's method of accounting.

The line of cases upon which the majority below relied (R. 13) is clearly distinguishable.[8] Those cases involved provisions of the Code imposing a penalty surtax on the undistributed profits of personal holding companies. In computing the amount of undistributed profits, Section 505(a) permitted, *inter alia*, the deduction of excess profits taxes "paid or accrued during the taxable year." The cases in question hold that for purposes of these penalty provisions, which are incorporated in the personal holding company surtax provisions of Sections 500 *et seq.*, Chapter 2, the definitions of "paid or accrued" contained in Chapter 1 (see Sections 43 and 48(c), discussed *supra*, pp. 12-13) need not be deemed controlling. Thus, speaking of Section 48(c), the court stated in the *Clarion Oil* case (148 F. 2d, p. 675):

> But, obviously, this definition was intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject matter of what, for the purposes of the

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is a taxable year under section 48(a), is a preceding taxable year.

The governing regulation (Treasury Regulations 111, Section 29.122-1) makes the same reference.

[8] *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (C.A. D.C.), certiorari denied, 325 U.S. 881; *Aramo-Stiftung* v. *Commissioner*, 172 F. 2d 896 (C.A. 2d); *Birmingham* v. *Loetscher Co.*, 188 F. 2d 78 (C.A. 8th); *Wm. J. Lemp Brewing Co.* v. *Commissioner*, 18 T.C. 586, 600-601, acquiesced in by the Commissioner, 1952-2 Cum. Bull. 2. The recent decision in *Harry M. Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D.

> newly added provision in relation to personal holding companies, is taxable as *undistributed* income.

However, under Section 23(s), here involved, "the net operating loss deduction computed under section 122" is deductible "*in computing net income.*" (Emphasis added.) Under the very reasoning of *Clarion Oil*, therefore, Chapter 1 definitions of "paid or accrued" control. To restate the point in the language of the court of appeals in the *Lewyt* case (215 F. 2d, p. 525):

> The Clarion and the other cases cited are inapplicable to the one before us. Here the meaning of "paid or accrued" in § 122(d)(6) is directly involved in the computation of *net income*, for § 23(s) allows as a deduction in "computing net income" under § 23 "the net operating loss deduction computed under section 122." In addition, to the extent that the meaning of "paid or accrued" is involved in the computation of the net operating loss itself by application of the § 122(d)(6) deduction, § 43 specifically gives it the same meaning as § 48(e) requires in connection with the computation of net income.

See, also, dissenting opinion of Judge Madden below. (R. 14.)

3. Respondent argues that the Government's construction should not be adopted because it would

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N.Y.), pending on appeal (C.A. 2d), involving surtax under Section 102 on corporations improperly accumulating surplus, is distinguishable on like grounds.

work an inequitable result. The contention is that while such a construction extends substantial benefits to a cash basis taxpayer, "it is almost impossible as a practical matter for an accrual basis taxpayer to incur a net operating loss under Chapter 1 * * * and in the same year incur an excess profits tax liability under Chapter 2E * * *." (Br. in Op. 11.)

We would point out, to begin with, that there are situations in which the statutory provision, as we construe it, will result in benefit to an accrual basis taxpayer. For example, an accrual basis taxpayer may derive benefit from Section 122(d)(6) if excess profits taxes for a given year are disputed and not settled until a later year.[9] Under the rule established by *Dixie Pine Co.* v. *Commissioner,* 320 U.S. 516, the disputed tax liability accrues in the year of settlement, which might, of course, be a loss year. It then becomes part of the net operating loss for that year. That was the precise situation before the Tax Court in *Robert Reis & Co.* v. *Commissioner,* 20 T.C. 294, 298-299, in which the court commented:

> In passing, we note that our holding refutes a contention made by the taxpayer in the *Lewyt* case. There it was argued that to construe "paid or accrued" as used in section 122(d)(6) as referring to the accounting system used by the taxpayer would deny ac-

[9] Originally, taxpayer claimed not only the 1945 tax paid in 1946 but also certain other taxes which accrued in 1946 as the result of a settlement in that year of disputed taxes for an earlier year. However, it subsequently abandoned its claim as to the accrued taxes (R. 5, 7.)

> crual basis taxpayers any benefit under the section. We point out that the accrual taxpayer here does get a benefit.

See, also, the court of appeals opinion in *Lewyt*, 215 F. 2d at 526.

Another instance is that of an accrual basis taxpayer which, having derived abnormal income during a given taxable period, allocated part of that income, for excess profits tax purposes, to a later tax year, as authorized by Code Section 721. The later year could, of course, be a loss year.[10]

More broadly, we would emphasize that innumerable individual provisions in the complex structure of the tax laws will have a differing incidence depending on the method of accounting utilized by the taxpayer. Thus, in 1940, when the excess profits tax took effect, the cash basis taxpayer was obliged to pay the tax on goods or services sold and delivered in 1939 for which payment was received in 1940. In the case of the accrual basis taxpayer, identical transactions were free from excess profits taxation. This example might be multiplied many times over. Such results will inevitably occur unless Congress should require all taxpayers to employ the same system of accounting for tax purposes. The underlying assumption upon which the tax laws operate is that when a taxpayer adopts a method of accounting (a taxpayer whose transactions are many and complicated usually finds the accrual method more desirable be-

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[10] Example 3, Appendix B, *infra*, p. 55, illustrates such a case.

cause expenses are more likely to be deducted in the year in which the income to which they relate is reported), the disadvantages which attach to that method will not, over the long run, outweigh the advantages. In substance, Congress has said to the taxpayer: You may exercise the option to keep your books on a cash basis or an accrual basis; but you may not compute your income and your deductions on one basis for purposes of one provision of the income tax laws and on another basis for purposes of another provision of those laws.

In rejecting arguments similar to those made by respondent, based upon alleged hardships to individual taxpayers or classes of taxpayers, this Court stated (*Crooks* v. *Harrelson*, 282 U.S. 55, 60):

> It is not enough merely that hard and objectionable or absurd consequences, which probably were not within the contemplation of the framers, are produced by an act of legislation. Laws enacted with good intention, when put to the test, frequently, and to the surprise of the law maker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law making authority, and not with the courts.

See also *Taft* v. *Commissioner*, 304 U.S. 351, 358-359; *Pillsbury* v. *United Eng. Co.*, 342 U.S. 197, 199-200.

B. *In any event, a deduction under Section 122(d)(6) must reflect an excess profits tax actually imposed. Taxpayer's claim here lacks this foundation*

We have argued above that taxpayer could not add its 1945 excess profits tax, paid in 1946, to its 1946 net operating loss because, as an accrual basis taxpayer, its tax accrued in 1945. Assuming, *arguendo,* however, that taxpayer could hurdle this obstacle, there is a further barrier to allowance of taxpayer's claim.

As pointed out in the Statement (*supra,* p. 4), the 1945 excess profits tax paid by taxpayer was subsequently refunded or credited in full as a result of a net operating loss carry-back from 1947. Thus, the 1945 excess profits tax liability was wiped out. And since no economic loss was suffered, the foundation upon which taxpayer seeks to augment its 1946 net operating loss is destroyed.

We would emphasize that Section 122(d)(6) allows as a deduction "the amount of [excess profits] tax *imposed* . . ." (emphasis added). A sum which was paid in the loss year, but was subsequently refunded, does not represent an amount of tax actually imposed. Certainly, there were not two amounts imposed for 1945; there was only one, and that one was the amount which finally became determinable after application of the 1947 carry-back.

Essentially the same question (though arising in a somewhat different context) is before this Court

in *Lewyt*, No. 417. As Judge Harlan stated for the court of appeals in that case, "The excess profits taxes ultimately found by the Commissioner to be due in respect of the year 1944 . . . rather than the uncorrected figure . . ." constituted "'the amount' of excess profits taxes 'imposed'" within the meaning of Section 122(d)(6). Application of this principle to the case at bar would require reversal of the Court of Claims' judgment here, entirely apart from the issue discussed in Point IA, *supra*.[10a]

II

The Legislative History Furnishes No Basis for a Departure from the Statutory Language

The discussion of the legislative history which follows is addressed to two questions: (a) Whether there is anything in the legislative antecedents and history of Section 122(d)(6) to show that the phrase "paid or accrued" used in that section was meant to have a meaning varying from the statutory definition of the term; and (b) whether the entire statutory scheme and history show that Congress proposed to extend to accrual basis taxpayers, through the deduction of excess profits taxes, benefits in addition to those which could be accorded them under the prevailing definitions of the statute.

A. The court below did not discuss taxpayer's argument, renewed in the brief in opposition to certiorari (pp. 7-9), based upon the legislative ante-

[10a] For a fuller discussion of this principle, we respectfully refer the Court to the Government's brief in No. 417.

cedents and history of Section 122(d)(6)—a failure which suggests that it found no support there for its conclusion. In the *Lewyt* case, the taxpayer advanced a similar argument, both in the Tax Court and in the court of appeals. Those courts found that the history of Section 122(d)(6) and its antecedents was inconclusive and provided no warrant for rejecting the statutory definition of "paid or accrued." See 18 T.C. at 1251-1252; 215 F. 2d at 524-525.

The committee reports, themselves, are silent in respect to the meaning of "paid or accrued" as used in Section 122(d)(6), and taxpayer's argument rests upon inferences which it seeks to draw from the omission of language used in a different context in an earlier year. That argument (summarized by the Second Circuit in *Lewyt*, 215 F. 2d at 524), is as follows:

Section 202(a) of the Revenue Act of 1941 amended Section 23(c) of the Internal Revenue Code to permit deduction of Chapter 2E excess profits taxes "paid or accrued within the taxable year" in computing net income, subject to certain rules provided in Section 23(c)(2).[11] The following year, the Revenue Act of 1942, c. 619, 56 Stat. 798, eliminated Chapter 2E excess profits taxes as

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[11] (2) *Excess-Profits Tax Under Chapter 2E—Special Rules.*—For the purposes of this subsection, in the case of the excess-profits tax imposed by Subchapter E of Chapter 2—

(A) The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year;

(B) No reduction in such tax shall be made by reason

a deduction in computing net income, but added a new section (Section 122(d)(6)) permitting the deduction of such excess profits taxes from gross income in computing the net operating loss, and net operating loss "carry-backs" and "carry-overs."[12] This was subject to rules substantially the same as those formerly contained in Section 23(c)(2), as amended by the Revenue Act of 1941, except that rule "A" of that section, quoted above (note 11), was omitted.

Pointing out that the effect of rule "A" in Section 23(c)(2) was to place a cash basis taxpayer substantially on the accrual basis so far as the excess profits tax deduction was concerned, taxpayer argues that the omission of that rule in Section 122(d)(6) suggests that Congress did not intend to place all taxpayers on the accrual basis. Accepting this inference, however, it certainly does not follow that Congress meant to give either class of taxpayers (accrual basis or cash basis) an election to deduct its excess profits taxes on a basis inconsistent with the method of accounting to which that class was committed.

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of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(C) Such tax shall be computed without regard to the adjustments provided in section 734; and

(D) Such tax, in the case of a consolidated return under section 730, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

[12] The elimination and the addition were accomplished by Sections 105(c) and 105(c)(3)(C) of the 1942 Act, respectively.

Indeed, this phase of the legislative history tends to support the Government's position that Congress used "paid or accrued," in Section 122(d)(6), in its customary, statutorily-defined sense. Rule "A" of Section 23(c)(2), as added by the 1941 Act, appeared in a section allowing the deduction of taxes "paid or accrued." It cannot be denied that the phrase "paid or accrued" was there used as a term of art, i.e., in its long-accepted, statutory sense. The professed purpose of Congress in the enactment of Rule "A" was to place all taxpayers, cash and accrual, on the same basis in respect to the deduction for excess profits taxes.[13] Congress did so, however, not by giving a right of election or by stating that a cash basis taxpayer might deduct "accrued" taxes; it expressly provided that any portion of such tax "paid" after the taxable year "shall be considered as having been paid within the taxable year."[14] The manner

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[13] H. Rep. No. 1040, 77th Cong., 1st Sess., p. 46 (1941-2 Cum. Bull. 413, 450); S. Rep. No. 673 (Part 1), 77th Cong., 1st Sess., p. 37 (1941-2 Cum. Bull. 466, 495-496):

> It is provided that the deduction shall be allowed only in computing the income tax imposed for the taxable year for which the excess-profits tax is levied. By providing that any excess-profits tax paid after the taxable year shall be deemed to have been paid within the taxable year, the same treatment is accorded to taxpayers on the cash basis as is accorded to taxpayers on the accrual basis.

[14] Contrast Code Section 131(d), dealing with the credit for foreign taxes, which provides, subject to certain conditions, that the credits may, "at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books," be taken in the year in which the taxes of the foreign country "accrued."

of effecting, for this purpose, similarity of treatment of cash and accrual basis taxpayers reflects a recognition of the settled meaning of "paid or accrued." The inferences to be drawn from the enactment of Rule "A" of Section 23(c)(2), therefore, are: (1) That Congress was aware of its own statutory definition of "paid or accrued," and (2) that when Congress desired to have cash and accrual basis taxpayers treated alike for certain purposes it knew how to accomplish its purpose. Accordingly, the omission of Rule "A" in the enactment of Section 122(d)(6) in 1942 may reasonably be taken as a continued recognition by Congress of the statutory meaning of "paid or accrued" and as evidence of a Congressional purpose limited to withdrawal of the presumption contained in Rule "A", i.e., the presumption that all excess profits taxes paid by a cash basis taxpayer were paid within the taxable year to which they pertained though in fact paid after the taxable year.

B. As pointed out above, under the 1941 Act the amount of the excess profits tax constituted a deduction for purposes of computation of the normal tax and surtax. This deduction was expressly eliminated under the Revenue Act of 1942 when a larger deduction was allowed in its place. The taxpayer, in computing the normal tax and surtax, is authorized by the 1942 Act to use as a credit the base upon which the excess profits tax is computed, i.e., the amount of the adjusted excess profits net

income.[15] Having thus allowed the base upon which the excess profits tax is computed as a credit, the further allowance of the tax itself as a deduction or credit grants *pro tanto* the same benefit twice over. There is no suggestion that such a double benefit is available to taxpayers with stable profits year in and year out. Yet the underlying purpose in the enactment of the net operating loss deduction was to avoid tax discrimination against businesses with alternating or fluctuating profit and loss years in favor of those with stable profits year in and year out.[16] Certainly, it was not to create a tax advantage in favor of the former; nor is it to be supposed that Congress, without saying that it was doing so, intentionally granted to taxpayers with fluctuating profits double benefits denied to taxpayers generally.

This conclusion is fortified by the fact that the 1942 Act was a war revenue measure notable for its increases in corporate income and excess profits taxes.[17] In the context of such a bill, it is particularly difficult to give credence to the notion that Congress proposed, in an incidental fashion and

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[15] Examples 1 and 2 (Appendix B, *infra*, pp. ~~53-54~~ 54-55) illustrate the differences in computation of the corporate income and excess profits tax between the years 1941 and 1942 resulting from this change of base accomplished by the 1942 Act.

[16] H. Rep. No. 855, 76th Cong., 1st Sess., pp. 9-10 (1939-2 Cum. Bull. 504, 510-511) which recommended the addition of Sections 23(s) and 122 to the Code by enactment of Section 211 of the Revenue Act of 1939, c. 247, 53 Stat. 862.

[17] Compare, *e.g.*, rates shown in Examples 1 and 2 (Appendix, B, *infra*, pp. ~~53-54~~ 54-55).

by an amendment which, as we show below, it characterized as "technical," to legislate a novel deduction authorizing the cancellation or refund of huge amounts of taxes.

The change effected by the 1942 Act in respect to the base for computation of corporate taxes was described in the pertinent Ways and Means Committee Report as follows (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 18 (1942-2 Cum. Bull. 372, 388):

> 1. Change in the Base for Corporate Tax
>
> Under the present law, the excess-profits tax is computed before the normal tax and surtax, being allowed as a deduction in determining the bases to which those taxes apply. Thus, the portion of the adjusted excess-profits net income not taken by the excess-profits tax is subjected to the normal tax and surtax.
>
> The bill changes this method of determining the tax base by dividing the net income into two portions, one of which is subject to excess-profits tax alone, and the other of which is subject only to normal tax and surtax. Instead of deducting the excess-profits tax itself in determining the normal and surtax bases, the bill deducts, through the form of a credit against net income, the adjusted excess-profits net income, the base upon which the excess-profits tax is computed.

This fundamental change was carried out by Section 105(a), (b) and (d) of the 1942 Act. Since the adjusted excess profits net income (and not the ex-

cess profits tax) was thereafter to be deducted in determining corporate normal and surtax bases. Section 105(c) repealed Section 23(c)(2) of the Code (note 11, *supra*, pp. 23-24), as originally added by the 1941 Act, and amended Section 23(c)(1)(B) by including excess profits taxes among those denied deduction (Appendix A, *infra*, p. 36).

Subsection (c) of Section 105, entitled "Technical Amendments Made Necessary by Change in Base for Corporate Tax," in its subparagraph (3) [18] amended Section 122 of the Code by adding,

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[18] (3) *Computation of net operating loss deduction.*—Section 122 (relating to net operating loss) is amended as follows:

(A) Subsection (a) is amended to read as follows:

"(a) *Definition of Net Operating Loss.*—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)."

(B) Subsection (c) is amended by striking out the parenthesis at the end thereof and inserting in lieu thereof the following: "and without the credit provided in section 26(c)".

(C) Subsection (d) is amended by striking out "exceptions and limitations" and inserting in lieu thereof "exceptions, additions, and limitations" and by inserting at the end thereof the following new paragraph:

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

"(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

"(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(C) Such tax, in the case of a consolidated return

inter alia, the (d) (6) provision here in question. Considered in context, it seems evident that Congress contemplated no major enlargement in the allowance of deductions in general or in the net operating loss deduction in particular. Indeed, in the language of the subsection's title, it contemplated only a "Technical Amendment [s] Made Necessary by Change in Base for Corporate Tax" in the "Computation of net operating loss deduction." This thought was expressed by John O'Brien, Office of Legislative Counsel, House of Representatives, who was called upon at the outset of the Senate hearings on the 1942 bill to explain the changes made by the House in the existing law (Senate Hearings before the Committee on Finance on H. R. 7378, 77th Cong., 2d Sess., p. 34). With respect to the language here under consideration, he stated (p. 41):

> Now, the rest of the amendments in this section are purely technical amendments relating to getting rid of the deduction for excess-profits tax which is in the present law, and various other amendments particularly in connection with the net operating loss, in order to make them come out right. You see, when you change the basis of corporate tax it involves any number of miscellaneous amend-

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for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary."

ments throughout in order to make it all come out straight.

As shown by their reports,[19] the committees of

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[19] S. Rep. No. 1631, 77th Cong. 2d Sess. pp. 66-67 (1942-2 Cum. Bull., pp. 504, 556):

> The amendments made by this section of the bill, which corresponds to section 105 of the House bill, change both the base and the rates of the corporation income tax. The change in base is made in lieu of the deduction now granted with respect to the excess profits tax imposed by chapter 2E. Section 13(a)(2) of the Code is amended to allow the amount of the adjusted excess profits net income as a credit in computing normal tax net income. This credit, as specified in section 26(e) as amended, is likewise provided under section 15(a) in determining the amount of surtax net income.
>
> * * * * *
>
> Section 23(c)(1) of the Code is amended by this section of the bill to deny the deduction for excess profits taxes paid or accrued for those years in which a credit is allowed under section 26(e).
>
> This section makes *other technical amendments required as a result of the change in the base* of the corporation tax. * * * Section 122 of the Code, relating to computation of the net operating loss deduction allowed by section 23(s) of the Code, is amended so as to allow the excess profits tax paid or accrued within taxable years (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carry-over and carry-back from, such taxable years. [Emphasis added.]

The House Report was substantially the same except that it employs language appropriate only to carry-overs, since carry-backs were first introduced in the Senate bill. Hence, instead of the last paragraph of the Senate Report, the House Report (H. Rep. No. 2333, *supra*, p. 65 (1942-2 Cum. Bull., *supra*, p. 423) reads as follows:

> This section makes other technical amendments required as a result of the change in the base of the corporation tax. * * * Section 122 of the Code, relating to computation of the net operating loss deduction allowed by section 23(s) of the Code, is amended so as to allow the excess

both Houses plainly accepted this view of the limited extent of the change involved.[20]

It would not be accurate to state that the under-

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profits tax paid or accrued within preceding taxable years (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carry-over from, such preceding taxable years.

A leading commentator has stated with respect to subsection (d)(6) that "The purpose of this provision is a matter of conjecture and Congressional committee reports and other availal le data are of no assistance on the question of intent," 5 Mertens, *Law of Federal Income Taxation* (1953 ed.), Section 29.02, p. 364. Certainly, there is no suggestion that Congress contemplated the far-reaching consequences which would flow from taxpayer's contention that the language of (d)(6) ("paid or accrued") is to be read in a special sense.

[20] There is a further indication that the (d)(6) amendment was not meant to have more than limited scope. Senator George of the Finance Committee introduced on the floor of the Senate a new amendment to be inserted at the proper place in the bill, "intended to eliminate duplications in the section as it was written, and to clarify certain provisions of the section." 88 Cong. Record, Part 6, p. 8015. The amendment became Section 210 of the Revenue Act of 1942, adding a new subparagraph (J) to Section 711(a)(1) of the Code and a new subparagraph (L) to Section 711(a)(2) (Appendix A, *infra*, pp. 44-46). These new subparagraphs provide, as an adjustment to normal tax net income in arriving at excess profits net income, that in computing the net operating loss for any taxable year under Section 122(a) "no deduction shall be allowed for any excess profits tax imposed by this subchapter." The court below (R. 16-19) did not doubt that these provisions preclude the deduction of excess profits taxes paid or accrued in determining a net operating loss to be carried back for excess profits tax purposes, if the excess profits tax is computed upon excess profits net income under Section 710(a)(1)(A). (Appendix A, *infra*, p. 43). The court, however, thought that if the excess profits tax is computed under Section 710(a)(1)(B) (Appendix A, *infra*, pp. 43-44) the tax is not based on excess profits net income, and hence it held that the limitation imposed by subparagraph (J) of Section 711(a)(1) and subparagraph (L) of Section 711(a)(2) is not applicable.

lying Congressional purpose in adding Section 122-(d)(6) is plainly expressed in the legislative history. See Mertens' comment, note 19, *supra*, p. 32. But, to recapitulate, what does emerge from the legislative history is the following:

(1) The language of the new subsection had its origin in Section 23(c)(2) as amended by the 1941 Act. In the framework of that Act, a taxpayer deducted its excess profits tax for purposes of computing its other corporate taxes (normal tax and surtax). When this was altered by the 1942 Act, which authorized a different and larger deduction, and hence a new method of computing the normal tax and surtax, Section 23(c)(2) providing for deduction of excess profits tax was repealed.

(2) The reappearance of this language in Section 122(d)(6), described as one of a "number of miscellaneous amendments" of a "technical" nature "made necessary by [the] change in base for corporate tax" and required "in order to make it all come out straight" (see *supra*, pp. 29-31), hardly suggests that Congress contemplated a novel and far-reaching deduction of the kind which taxpayer urges—a deduction which would permit a corporation, whether on cash or accrual basis, to deduct all excess profits taxes, both paid and accrued within any taxable year, for purposes of determining its net operating loss.

Since it may be fairly stated that, whatever else was contemplated (or overlooked), there is no evidence of an express or implied intention to work a

major change, the legislative history, far from supporting the view that (d)(6) should be construed without regard to the statutory definition of "paid or accrued," emphasizes the wisdom of confining the amendment within the limits of its statutorily-defined terminology.[21] The Court of Claims thus erred we believe, in concluding that it was justified in doing "violence to the letter of the Act." (R. 13.)

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[21] The court below adopted precisely the contrary approach. It refused to apply the phrase "paid or accrued" as used in Section 122(d)(6) with its established meaning and thus extended the operation of the section to cases not embraced within that meaning. On the other hand, it read Section 710(a)(1)(B) with literalness in order to give indirectly to the taxpayer here benefits expressly denied directly to taxpayer by Section 711(a)(1)(J) and 711(a)(2)(L). See note 20, *supra*, p. 32. The court further ignored the fact that a net operating loss carry-back from 1947 to 1945 resulted in a refund to taxpayer of the entire 1945 excess profits tax paid in 1946; yet, at the same time, it has here permitted the payment of the same 1945 excess profits tax in 1946 to be carried back as a net operating loss to 1944. Inconsistently with its refusal to consider the effect of the 1947 carryback, it has then employed the reduced 1944 corporation surtax resulting from the 1946 carry-back as constituting the base for computing the limit under Section 710(a)(1)(B) of the excess profits tax which might properly be imposed for 1944. These certainly are results never contemplated by Congress.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Claims should be reversed.

Respectfully submitted,

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JANUARY, 1955

APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [As amended by Sec. 202(a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in General.*—Taxes paid or accrued within the taxable year, except—

(A) Federal income taxes;

(B) [As amended by Sec. 105 (c) (1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

* * * * *

(s) [As added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1952 ed. Sec. 23.)

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41—GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred" dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deduc-

tions or credits should be taken as of a different period. * * *

(26 U. S. C. 1952 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) *"Paid or Incurred," "Paid or Accrued."*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 1952 ed., Sec. 48.)

SEC. 122. [As added by Sec. 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [As amended by Sec. 105 (e) (3) (A) of the Revenue Act of 1942, *supra*]. *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 153(a) of the Revenue Act of 1942, *supra*]. *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) *Net operating loss carry-over.*—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss

deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(e) [As amended by Secs. 105(e) (3) (B) and 153(b) of the Revenue Act of 1942, *supra*] *Amount of Net Operating Loss Deduction.*— The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (com-

puted without such deduction and without the credit provided in section 26(e));

(d) [As amended by Sec. 105(e) (3) (C) of the Revenue Act of 1942, *supra*] *Exceptions, Additions, and Limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) [As amended by Sec. 150(e) of the Revenue Act of 1942, *supra*] Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains;

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U. S. C. 1952 ed., Sec. 122.)

SEC. 710 [as added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974]. IMPOSITION OF TAX.

(a) [as amended by Sec. 201 of the Revenue Act of 1941, *supra*] *Imposition.*—

(1) [as amended by Sec. 202 of the Revenue Act of 1942, *supra*] *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) [as amended by Sec. 202 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] 95 per centum of the adjusted excess profits net income, or

(B) [as amended by Sec. 202(b) of the Revenue Act of 1943, *supra*] an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter), and without regard to 80 per centum of

the credit provided in section 26 (h) (relating to credit for dividends paid on certain preferred stock).

* * * * *

(b) *Definition of Adjusted Excess Profits Net Income.* As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

(1) [as amended by Sec. 204 of the Revenue Act of 1943, *supra*] *Specific exemption.*—A specific exemption of $10,000;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under section 712; and

(3) [as amended by Sec. 2 (a) of the Excess-Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and Sec. 204 (a) of the Revenue Act of 1942, *supra*] *Unused excess profits credit.*—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

* * * * *

(26 U. S. C. 1952 ed., Sec. 710).

SEC. 711 [as added by Sec. 201 of the Second Revenue Act of 1940, *supra*]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a)(2), for such year except that the following adjustments shall be as follows:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(J) [as added by Sec. 210(a) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year: * * *

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(L) [as added by Sec. 210(b) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year: * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 711.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.41-1. *Computation of Net Income.*—

* * * * *

* * * The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41-2. *Bases of Computation and Changes in Accounting Methods.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to

be properly accounted for as of a different period. But see sections 42 and 43. See also section 48. * * *

* * * * *

Sec. 29.43-1. *"Paid or Incurred" and "Paid or Accrued."*—(a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Internal Reve-

nue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

* * * * *

Sec. 29.122-1. *Net Operating Loss Deduction.*—(a) *General.*—Section 122 provides the rules for the computation of the net operating loss deduction allowed by section 23 (s). The net operating loss deduction is the aggregate of the net operating loss carry-overs and carry-backs to the taxable year, reduced by certain adjustments to prevent the deduction of losses absorbed by income not taxed.

* * * * *

A fractional part of a year which is a taxable year under section 48 (a) is a preceding or succeeding taxable year for the purpose of determining under section 122 the first, second, or third preceding taxable year or the first or second succeeding taxable year.

* * * * *

(b) *Steps in computation of net operating loss deduction.*—There are three steps in the ascertainment of the net operating loss deduction. The first step is the computation of the net operating loss, if any, for the two preceding taxable years and for the two succeeding taxable years. The second is the computation of the net operating loss carry-overs to the taxable year from such preceding tax-

able years and the computation of the net operating loss carry-backs to the taxable year from such succeeding taxable years. The third is the conversion of the aggregate of such net operating loss carry-overs and carry-backs into the net operating loss deduction.

* * * * *

Sec. 29.122-2. *Computation of Net Operating Loss In Case Of Corporation.*—A net operating loss is sustained by a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over gross income, both computed with the following exceptions, additions, and limitations:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by chapter 1, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) For any taxable year beginning after December 31, 1938, and before January 1, 1942, the amount deductible on account of long-term capital losses shall not exceed the amount includible on account of long-term capital gains, and the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of short-term capital gains. For any taxable year beginning after December 31, 1941, the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of such assets; and

(5) For taxable years beginning after December 31, 1941, there shall be allowed as a deduction the amount of excess profits tax imposed by subchapter E of chapter 2 paid or accrued within the taxable year, subject, however, to the provisions of section 122 (d) (6) (A), (B), and (C).

The application of this section may be illustrated by the following example:

Example. For the year 1942 the X Corporation, which makes its income tax returns on the calendar year basis, has gross income as defined in section 22 of $400,000 and deductions allowed by section 23 of $300,000, ex-

clusive of any net operating loss deduction. Included in gross income are long-term capital gains of $50,000 and short-term capital gains of $25,000. The corporation had long-term capital losses of $60,000 and short-term capital losses of $35,000, which are deductible to the extent of the capital gains, or $75,000.

The X Corporation also deducted $75,000 for depletion on a percentage basis. If depletion had been computed without reference to percentage depletion, the amount of such deduction would have been $5,000. For 1942 the X Corporation also had $35,000 of wholly tax-exempt interest, and paid $15,000 in interest on indebtedness incurred to carry the obligations from which such tax-exempt interest was derived.

On the basis of these facts the X Corporation has a net operating loss for the year 1942 of $110,000, computed as follows:

(1) Deductions for 1942		$600,000
Less:		
(2) Excess of percentage depletion over cost ($75,000 minus $5,000)		70,000
(3) Deductions adjusted as required by section 122 (d) (item (1) minus item (2))		530,000
(4) Gross income for 1942	$400,000	
(5) Plus tax-exempt interest minus interest paid ($35,000 minus $15,000)	20,000	

(6) Gross income adjusted as required by section 122 (d) (item (4) plus item (5))	420,000
(7) Net operating loss for 1942 (item (3) minus item (6))	110,000

APPENDIX B

Example 1

Illustration of

Computation of Corporate Income and Excess Profits Tax for Taxable Year Ended December 31, 1941

Income Tax

Net Income (also normal tax net income without deduction of excess profits tax)			$100,000 00
Less: Excess Profits Tax (last line below)			17,000 00
Normal tax net income			$ 83,000 00
Normal tax—24% of $83,000 00			19,920 00
Surtax net income		$83,000 00	
Surtax:			
On first $25,000.00 @ 6% of $25,000.00	$1,500		
On excess over $25,000 @ 7% of $58,000	4,060		5,560 00
Income Tax			$ 25,480.00

Excess Profits Tax

Excess Profits Net Income (same as first line above)			$100,000 00
Less:			
Specific Exemption		$ 5,000 00	
Excess Profits Credit (assumed)		50,000 00	55,000 00
Adjusted excess profits net income			$ 45,000 00
First $20,000 @ 35%	($20,000)		$ 7,000 00
Next $30,000 @ 40%	($25,000)		10,000 00
Excess Profits Tax			$ 17,000 00

Example 2

Illustration of

Computation of Corporate Income and Excess Profits Tax for Taxable Year Ended December 31, 1942

Income Tax

Net Income (without allowance of credit for income subject to excess profits tax (section 26(e))	$100,000 00
Less: Adjusted excess profits net income (line 4 below)	45,000 00
Normal tax net income	$ 55,000 00
Normal Tax—24%	13,200 00
Surtax—16%	8,800 00
Income Tax	$ 22,000 00

Excess Profits Tax

Excess Profits Net Income (same as first line above)		$100,000.00
Less:		
Specific exemption	$ 5,000.00	
Excess Profits Credit	50,000.00	55,000.00
Adjusted excess profits net income		$ 45,000.00
90% of $45,000.00		40,500.00
Computation of the 80% Limitation:		
Surtax Net Income (prior to sec. 26(c) credit)	$100,000.00	
80% of $100,000.00	80,000.00	
Less: Chapter 1 Income tax (line 6 above)	22,000.00	
Limitation of excess profits tax	$ 58,000.00	
Excess Profits Tax ($58,000 or $40,500, whichever is lesser)		$ 40,500.00

Example 3

Illustration of Accrual of Excess Profits Tax in Year of Net Operating Loss During Which Abnormal Income Is Attributable under Section 721 (d).

A corporation is on the accrual basis.

A corporation's net income for the calendar year 1944 was $200,000.00. The excess profits net income was also $200,000.00 which included $100,000.00 abnormal income attributable to 1945. For the calendar year 1945, A corporation sustained a net operating loss of $5,000.00. A corporation's excess profits credit was $50,000.00 for the years 1944 and 1945. The limitation on the tax provided by section 721 (d) (1) is not applicable.

Computation of Tax for 1945

Income Tax

Normal tax net income	($ 5,000.00)
Normal tax and surtax	-0-

Excess Profits Tax

Normal tax net income		($ 5,000.00)
Abnormal income from 1944 attributable to 1945		100,000.00
Excess profits net income		$ 95,000.00
Less:		
Specific exemption	$ 10,000.00	
Excess profits credit	50,000.00	60,000.00
Adjusted excess profits net income		$ 35,000.00
95% of $35,000.00		$ 33,250.00
Computation of the 80% Limitation:		
Surtax net income	($ 5,000.00)	
Plus: Abnormal income	100,000.00	
Adjusted surtax net income	$ 95,000.00	
80% of $95,000.00	76,000.00	
Less: Actual income tax under Chapter 1	-0-	
Limitation on excess profits tax	$ 76,000.00	
Excess profits tax (lesser of $76,000 or $33,250)		$ 33,250.00

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No. 10

IN THE

Supreme Court of the United States

October Term 1953

THE UNITED STATES OF AMERICA, *Petitioner*

v.

OLYMPIC RADIO AND TELEVISION, INC., *Respondent*

On Petition for a Writ of Certiorari to the United States Court of Claims

BRIEF FOR THE RESPONDENT IN OPPOSITION

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Counsel for Respondent

Of Counsel:
FRED R. TANSILL

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In The

Supreme Court of the United States

October Term 1953

No. 100

The United States of America, *Petitioner*

v.

Olympic Radio and Television, Inc., *Respondent*

On Petition for a Writ of Certiorari to the United States Court of Claims

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Claims on plaintiff's and defendant's motions for summary judgment, and the dissenting opinions were entered November 4, 1952. Judgment was entered the same day. (R. 10-14). These opinions are reported at 108 F. Supp. 109. The opinion of the Court of Claims denying defendant's motion for rehearing, and the dissenting opinions were entered March 3, 1953. (R. 16-19). These opinions are reported at 110 F. Supp. 600.

JURISDICTION

The opinion and judgment of the Court of Claims were entered November 4, 1952. (R. 14.) On December 3, 1952, the Government filed a motion for rehearing. On March 3, 1953, the court denied the motion. (R. 19.) On May 29, 1953, application for *writ of certiorari* was filed by the petitioner. Petitioner invokes the jurisdiction of this Court under 28 U.S.C., Section 1255 (1). The respondent contends that jurisdiction does not lie in this proceeding for failure to file a timely petition within the meaning of 28 U.S.C., Section 2101 (c).

QUESTIONS PRESENTED

1. Was the petition for a *writ of certiorari* timely filed?

2. Did the Court of Claims err in construing the intent of Congress to be that the phrase "paid or accrued", appearing in Section 122(d)(6) of the Internal Revenue Code, did not refer to methods of accounting and, therefore, permits an accrual basis taxpayer to take as a deduction the amount of excess profits tax paid in 1946 in computing the net operating loss for that year?

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code here applicable, are set forth in the Appendix, *infra*, pp. 17-20.

STATEMENT

This case was submitted to the Court of Claims on motions for summary judgment filed by both parties, together with supporting affidavits. The undisputed facts are briefly as follows:

The taxpayer, a New York Corporation, was and is a manufacturer of television and radio receiving sets, with its office and principal place of business at 34-01 38th Avenue, Long Island City, New York. Plaintiff kept its books and accounts on the accrual basis and filed its Federal corporation tax returns on the same basis using a calendar year (R. 1).

The taxpayer's Federal corporation income tax return, filed for the calendar year 1946, disclosed no income tax liability and reflected a net operating loss for the year 1946 of $324,844.23. Upon audit of this tax return, the Bureau of Internal Revenue reduced the net operating loss for the year 1946 to $310,872.60, to which the taxpayer agreed. The latter amount neither included nor reflected any adjustment or addition on account of excess profits taxes paid by the taxpayer to the Collector of Internal Revenue in 1946, within the meaning of 122(d)(6) of the Internal Revenue Code. (R. 2, 11.)

Within the calendar year 1946, taxpayer paid a total of $263,272.80 in excess profits taxes to the Collector of Internal Revenue. (R. 2.)

On or about June 11, 1948, taxpayer filed a claim for refund of income and excess profits taxes for the year 1944 with the Collector of Internal Revenue, said claim being in the face amount of $191,004.04. That refund claim was based upon the provisions of Section 122(d)(6) of the Internal Revenue Code, and asserted the taxpayer's right, in computing the correct net operating loss for 1946, to include the sum of excess profits taxes actually paid by the taxpayer to the Collector of Internal Revenue within 1946. (R. 2, 3, 11.)

Upon the failure of the Collector of Internal Revenue to take any action with respect to said refund claim within six months after the filing of said claim, the tax-

payer filed petition in the United States Court of Claims on June 14, 1952 (R. 1-3).

On November 4, 1952, the Court of Claims promulgated its opinion granting the taxpayer's motion for summary judgment, and denying the defendant's motion for summary judgment. Judgment was thereupon entered on the same day in the taxpayer's favor in the sum of $148,841.72, with interest as provided by law. The opinion of the Court of Claims held that the taxpayer was entitled to include as a deduction in computing its 1946 net operating loss, the amount of excess profits taxes paid in 1946 under the provisions of Section 122(d)(6) of the Internal Revenue Code. (R. 10-14.)

REASONS FOR DENYING THE WRIT

The respondent advances the following contentions as reasons for denying the writ: 1) the petition for *writ of certiorari* was not timely filed; 2) the decision below is clearly correct; 3) there is no conflict of decision; and 4) there is no important issue involved.

I

PETITION FOR A WRIT OF CERTIORARI WAS NOT TIMELY FILED

The issue of timeliness of a petition for *certiorari* is not a new one in this Court. A recent decision of this Court, *Federal Trade Commission v. Minneapolis Honeywell Regulator Company*, (1952) 344 U. S. 205, contains a pertinent discussion of this problem by the Chief Justice.

After observing that the petitioner's interpretation of this Court's prior decisions was too liberal, the Chief Justice stated:

> "While it may be true that the Court of Appeals had the power to supersede the judgment of July 5, with a new one, it is also true, as that court itself has recognized, that the time within which a losing party must seek review, cannot be enlarged just because the lower court in its decision thinks it should be enlarged. Thus the mere fact that a judgment previously entered, has been re-entered or revised in an immaterial way, does not toll the time within which review must be sought. Only when the lower court changes matters of substance, or resolves a genuine ambiguity in a judgment previously rendered, should the period within which an appeal must be taken, or a petition for certiorari filed begin to run anew. The test is a practical one. The question is whether the lower court, in its second order has disturbed or revised legal rights and obligations, which by its prior judgment had been plainly and properly settled with finality."

The opinion in the cited case, closes with the admonition to heed the principle that "litigation must at some definite point be brought to an end."

Applying the principles just stated to the present proceeding, the opinion of the Court of Claims was rendered on November 4, 1952. On that date judgment was also entered, as ordered, in the plaintiff's favor against the defendant in the amount of $148,871.72, with interest. That opinion and decision is the one from which the petitioner here seeks to appeal. On December 3, 1952, the defendant below filed motion for re-hearing with the Court of Claims. That motion was opposed by the plaintiff below, in part based upon the averment that the defendant's brief in support of its motion for re-hearing failed to advance any significantly new and different arguments from those already presented to the Court of Claims.

On February 3, 1953, the motion for re-hearing was argued. On March 3, 1953, the Court of Claims rendered its opinion on defendant's motion for re-hearing. That

opinion concluded with the statement "The judgment heretofore entered in the sum of $148,841.72 will stand."

A reading of the opinion of March 3, 1953, discloses that it is confined to the very narrow question of whether or not the distinction which had been made by the taxpayer between Section 710(a)(1)(B) and Section 710(a)(1)(A) was valid. The same point had been argued in the original briefs, and reply briefs in the Court of Claims proceeding, and also had been raised during oral argument. While it is true that the opinion of the Court of Claims of November 4, 1952, is silent on this matter and that its opinion of March 3, 1953, treats it in detail, the fact remains that the opinion of March 3, 1953, does *not* "change matters of substance." Nor does it resolve a genuine ambiguity. It is obvious that the Court of Claims' second opinion, neither disturbed nor revised any legal rights or obligations, settled by its prior opinion and judgment. See also *Department of Banking v. Pink*, (1952) 317 U.S. 264.

The principle enunciated in *Federal Trade Commission v. Minneapolis Honeywell Regulator Company, supra*, should apply in this instance. The 90-day period within which the defendant below could have applied for a *writ of certiorari* expired on February 2, 1953. 28 U.S.C. Sec. 2101(c). Petition for *writ of certiorari* was filed on May 29, 1953.

Recognition of the respondent's argument on this point would not mean that a losing party in the Court of Claims, in a situation such as this would be left without a remedy. The defendant below could have applied for an extension of time from a Judge of this Court, 28 U.S.C., Sec. 2101(c), or it could have filed a timely petition for a *writ of certiorari* as a protective measure.

The fact that the application for *certiorari* under consideration was filed on May 29, 1953, requires the conclusion that such application was not timely filed.

II

DECISION BELOW IS CLEARLY CORRECT

The Court of Claims proceeding involving this taxpayer presented a novel tax issue to that court. At the nub of the problem presented, was the necessity of construing the phrase "paid or accrued", appearing in Section 122 (d)(6) of the Internal Revenue Code. The taxpayer contended that these words should receive their usual commercial sense.[1] That is, "paid" meant liquidation of an outstanding tax liability by actual payment and "accrued" meant the coming into existence of such a liability. The respondent below contended that these words referred to methods of accounting. The Court of Claims accepted the former contention and found for the taxpayer.

Three fundamental lines of reasoning support the result reached by the Court of Claims. These are: First, the legislative antecedents and history of Section 122(d)(6) lead to that conclusion; second, the same result has been reached in an analogous situation[1]; and third, the contention of the defendant below leads to such incongruous and inequitable results that such results could not have been intended by Congress.

With reference to the first proposition, Section 122(d)(6) was inserted in the Internal Revenue Code by Section 105(c)(3) of the 1942 Revenue Act. It was made effective for taxable years beginning after December 31, 1941.

[1] In 1940, Section 23(c) of the Internal Revenue Code as it then read, permitted a direct deduction against net income for taxes paid or accrued within the taxable year, with certain exceptions. Included among those exceptions, were excess profits taxes. Section 202(a) of the

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[1] See *Commissioner v. Clarion Oil Company*, (CCA DC 1945), 148 F. (2d) 671, cert. den. 325 U.S. 881.

Revenue Act of 1941, removed excess profits taxes under Chapter 2E, from the list of exceptions to the general deduction rule contained in Section 23(c) of the Code. Simultaneously, the Revenue Act of 1941 added new subparagraph (2) to Section 23(c), which permitted a direct deduction in computing net income for excess profits taxes paid or accrued within the taxable year, subject to certain limiting rules. Rule A of subparagraph (2) effectively placed all taxpayers on the accrual basis of accounting with respect to the excess profits tax payments described.[2]

The Revenue Act of 1942, by Section 105(c), repealed Internal Revenue Code, Section 23(c)(2), and, simultaneously, restored excess profits taxes to the list of exceptions to the deduction rule permitted by Section 23(c). Thus, the right of deduction formerly accorded to excess profits taxes paid or accrued was withdrawn by the 1942 Revenue Act.

The very same section of the 1942 Revenue Act, which restored excess profits taxes to the list of exceptions to the tax deduction provision, added the new provision—Section 122(d)(6)—to the Internal Revenue Code.

The only pertinent Congressional language is the following:[3]

> "Section 122 of the Code relating to computation of the net operating loss deduction allowed by 122(c) of the Code is amended so as to allow excess profits tax paid or accrued within taxable years (subject to certain rules) as a deduction in computing net oper-

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[2] Rule (A) read as follows: "(A) The deductions shall be limited to the tax imposed for the taxable year but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year;"

[3] Senate Report No. 1631, 77th Congress, 2nd Session, page 67, and House Report No. 2333, 77th Congress, 2nd Session, page 65.

ating loss for, and net operating loss carry over and carry back from, such taxable years."

Rules (A), (B) and (C) in Section 122(d)(6) are almost verbatim copies of Rules (B), (C) and (D) formerly appearing in Section 23(e)(2). Significantly, Rule (A) under the latter section, which had effectively placed all taxpayers on the accrual basis, does not appear as a Rule under Section 122(d)(6). The question thus arises as to the significance of the apparently deliberate omission of Rule (A) of Section 23(e)(2) from the Rules contained under Section 122(d)(6). The maxim, *inclusio unius est exclusio alterius* suggests that the Congress, by the enactment of Section 122(d)(6) omitting Rule (A), did *not* intend to place all taxpayers on the accrual basis.

Can it be validly assumed that by the omission of Rule (A), Congress intended to place each taxpayer upon the basis of its own method of accounting? At first blush, it might appear that such meaning would be in accord with the definition of "paid or accrued" contained in Section 48(e) and hence the deduction would be controlled by Section 43. However, both sections have reference to "net income" and Section 43 refers to "deductions." Technically, neither concept is here involved.

Subparagraph 6 of Section 122(d) as well as the other 5 adjustments under Section 122(d) are all designed to convert net income or net operating loss, respectively, into economic net income, or economic net loss, as the case may be.[4] When Section 122(d)(6) is read in conjunction with Section 122(a), the effect is that a net operating loss becomes economic net loss. The payment of excess profits taxes in 1946 by the taxpayer was a true economic loss to the taxpayer in that year.

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[4] See 5 Mertens, Law of Federal Income Taxation, 305-6, Sec. 29.02.

After a net operating loss (Section 122(a)) has been converted into economic net loss (Section 122(d)), that economic net loss is what is carried back and applied to prior years. When that loss is carried back and converted into a net operating loss deduction (Section 122 (c)), the net income of the year of application itself first must be converted into economic net income. Section 122(c). Thus net income, as such, is *not* ultimately involved either in the loss year or year of deduction. That this distinction between net income and some other statutory concept such as economic net income is not a superrefined legalism is illustrated in a parallel situation involving the distinction between net income and subchapter A net income. Compare *Commissioner v. Clarion Oil Company, supra.*

One other point is significant in this regard. Conventional deductions, as such, are not involved. What is involved is a *tax*. The coming into existence of a liability for a tax is referred to by the word "accrued." The liquidation of a pre-existing tax liability by actual payment is referred to by the word "paid." The heading of Section 122(d) refers to "Exceptions, additions and limitations", not "deductions." The only one of these three words which could be applicable in the computation of a net operating loss where Section 122(d)(6) is involved is the word "additions." This refers to the amount of excess profits taxes "paid or accrued" which are to be *added* to the net operating loss otherwise computed.

The parallel type of situation referred to above, is illustrated by such cases as *Commissioner v. Clarion Oil Company, supra; Birmingham et al, Exrs. v. The Loetscher Company*, (C.C.A. 8 1951) 188 F. (2d) 78; *Aramo Siffuna v. Commissioner*, (C.C.A. 2 1949) 172 F. (2d) 896; *Wm. J. Lemp Brewing Company*, (1952) 18 T.C. ....., No. 70. All of these cases demonstrate that where "net

income" is not specifically involved, Sections 43 and 48(c) of the Internal Revenue Code are not controlling. They, therefore, also stand for the proposition that in such a case the phrase "paid or accrued" does not refer to accounting methods but rather refers to the liquidation of a tax liability or the coming into existence of such a liability. In these respects, the cited cases closely parallel the present proceeding.

The final reason for the correctness of the Court of Claims decision becomes apparent from a brief consideration of the effect of the petitioner's argument with respect to the proper meaning of the quoted phrases. This will illustrate the inequitable and discriminatory results flowing from the petitioner's construction of "paid or accrued." Fundamentally, every corporate taxpayer regardless of its method of accounting, must file its return within 2½ months after the close of its taxable year. The liability for tax reflected on such return is required to be paid in four quarterly installments during the year following the return year. This is the usual or conventional way in which a corporate taxpayer liquidates its liabilities for tax, regardless of accounting methods. A cash basis corporation, paying its prior year's excess profits tax liability in a loss year would, under the petitioner's theory, always would be entitled to make the Section 122(d)(6) adjustment while an accrual basis taxpayer in the identical situation would not.

If, as contended for by the petitioner, the phrase "paid or accrued" refers to accounting methods then it follows that it is virtually impossible for any accrual basis taxpayer to derive benefit from Section 122(d)(6) in such a situation. While it is mathematically possible it is almost impossible as a practical matter for an accrual basis taxpayer to incur a net operating loss under Chapter I of the Internal Revenue Code, and in the same year incur an excess profits tax liability under Chapter 2E of the

Internal Revenue Code to be accrued. Nearly all corporate taxpayers compute net income on the accrual basis of accounting. They would be foreclosed in a normal situation while the very few cash basis taxpayers would all benefit.[5] It can scarcely be argued that Congress intended such a discriminatory and inequitable result. The taxpayer's interpretation of the words in question, would benefit either a cash basis or an accrual basis taxpayer equally where either had a loss year following a profit year in which an excess profits tax liability arose. It was this basic equitable consideration which apparently weighed heavily in the Court of Claims and induced it to find for the taxpayer.

The Court of Claims chose to premise its findings on the ground that it was necessary to make an exception in this case to the general rule prohibiting the shifting from the "paid" to the "accrued" basis or vice versa. The Court of Claims, in taking that position, did so in order to reach a result giving effect to the plain "intention of Congress."

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[5] There is an unusual type of situation which can also arise. That is where *additional* taxes, deficiencies, are involved. If there is a dispute as to the liability for these additional taxes which postpones accrual and such dispute continues to and is settled in a loss year then, under either party's theory of "accrued," the result would be the same for an accrual basis taxpayer. Compare GCM 25298, 1947-2 Cum. Bull. 39.

If a cash basis taxpayer were involved, and no payment was made in the settlement year then under the respondent's theory there would be no proper Section 122(d)(6) adjustment; under the taxpayer's theory the tax would "accrue" and be a proper adjustment.

If the additional tax liability settled was also *paid* to the Collector in the same year settled, then under either theory Section 122(d)(6) would apply. The payment as well as the settlement would fix the time of accrual under respondent's accounting method theory. *Robert Reis & Co.*, (1953) 20 T.C. — No. 36, and, under taxpayer's theory, both actual liquidation of a liability and the coming into existence of a liability would have occurred.

There would appear to be another equally valid rationalization supporting the Court of Claims' result which would avoid the necessity of ignoring the rule against shifting bases. That alternative, as contended for by the taxpayer, is that the phrase "paid or accrued" is ambiguous, being susceptible of the two different constructions previously mentioned. In the presence of such ambiguity, the Court of Claims properly exercised its judicial prerogative and resolved the ambiguity, by ascertaining the Congressional intent. That intent was that the taxpayer should be permitted to carry back a net operating loss to a former year, and that to this loss there should be added excess profits taxes "paid or accrued" in the loss year. As previously shown, the payment of an excess profits tax is an economic loss, which increases the loss permitted to be carried back under Section 122(d)(6).

III

THERE IS NO CONFLICT OF DECISION

The petitioner here makes the point that the decision of the Court of Claims involving this taxpayer is directly in conflict with certain decisions of the Tax Court of the United States. That being so, such a situation does not create that kind of a conflict in which this court normally grants a *writ of certiorari*. Nowhere in this Court's Rule 38(5) is there any reference to a conflict between the Court of Claims and The Tax Court of the United States. The latter court is, of course, only an administrative agency, a part of the Executive Branch of the Government. *Edward D. Whitehead v. U. S.*, decided January 13, 1953, Court of Claims No. 49572.

While it is clear that a *writ of certiorari* can issue where there is a direct conflict of decisions between a Court of Appeals and the Court of Claims, *Helvering v.*

the International Life Insurance Company, (1935) 294 U.S. 686, 689, the respondent has been unable, despite diligent search, to find a single case in which a conflict between the Tax Court of the United States on the one hand, and the Court of Claims or a Court of Appeals on the other has resulted in the issuance of a *writ of certiorari* by this Court.

The Circuit Courts of Appeal, and the United States Court of Appeals for the District of Columbia have exclusive jurisdiction to review decisions of the Tax Court of the United States. Title 26 U.S.C., Section 1141. There is a theoretical possibility in the future that a *bona fide* conflict might develop, which might warrant an exercise of this Court's discretion in issuing a *writ of certiorari*. That might occur should the taxpayers against whom decisions were rendered in the Tax Court involving Section 122(d)(6) appeal to some Circuit Court of Appeals and that court sustained the Tax Court. However, an attempt at this time to invoke the authority of this Court appears to be premature.

Even if it be assumed that the conflict between the Tax Court of the United States and the Court of Claims is that kind of conflict in which *certiorari* may issue, then that fact, in and of itself, does not warrant the inevitable conclusion that this court must grant *certiorari*. See *Robert L. Stern, Denial of Certiorari Despite a Conflict, Harvard Law Review*, January, 1953.

This proceeding does not involve that kind of matter in which the Court of Claims has exclusive jurisdiction over some unique type of statutory proceeding. Tax matters are certainly not unique, and the Court of Claims does not have exclusive jurisdiction thereof.

IV

THERE IS NO IMPORTANT ISSUE INVOLVED

The petitioner states (p. 5), that it is informed by the Treasury Department, that the same issue is presented in at least 35 (and probably more) other cases, now pending before various courts and the Treasury Department, involving $27 million in taxes, plus interest. Aside from the fact that this unsupported allegation should receive no consideration, it seems clear that under this court's previous decisions, such facts, even if true, do not furnish adequate grounds for *certiorari*.

Where large amounts of money are involved, such a fact may be persuasive for *certiorari* although normally not so unless the amount is enormous. See *U. S. v. Zazove*, (1948) 334 U. S. 602, 613-14, Note 17. The principle at issue in that case could have involved billions of dollars. The number of individuals affected by a decision may be persuasive. One example of this type of situation is *Patterson v. Lamb*, (1947) 329 U. S. 539. In that case thousands of World War I draftees were directly affected. There is in this case no such pressure of equity.

Where a lower court's decision is at variance with well established administrative construction, *certiorari* may issue. *U. S. v. Ruzicka*, (1946) 329 U. S., 287. There a review was granted where a lower court's decision upset 25 years of consistent rulings and practice by the War Department. Here there is no well established administrative construction such as existed in the case cited.

If the Court of Claims decision be assumed to be in error as a matter of law, then that fact alone would not warrant the issue of the writ. This Court is not primarily concerned with the correction of errors in lower

court decisions. Hence, it generally will not grant *certiorari* just because the decision below may be erroneous. See *Supreme Court Practice*, Robert L. Stern, Eugene Gressman, Bureau of International Affairs, Inc., 1950, p. 113.

Section 304(e) of the Excess Profits Tax Act of 1950 made Internal Revenue Code Section 122(d)(6) inapplicable with respect to taxable years ending after June 30, 1950. Therefore, the present issue is not a recurring one and can involve only the years ending prior to June 30, 1950. The significance of the highly technical issue here involved has only a comparatively narrow scope even in its broadest implications.

CONCLUSION

For the reasons above stated, the petition for *writ of certiorari* to the United States Court of Claims in this proceeding should be denied.

Respectfully submitted

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APPENDIX

Internal Revenue Code:

Sec. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

(c) TAXES GENERALLY.—

• • •

"(2) Excess-profits tax under Chapter 2E—special rules.—For the purposes of this subsection, in the case of the excess-profits tax imposed by Subchapter E of Chapter 2—

"(A) The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year;

"(B) No reduction in such tax shall be made by reason of the credit for income war-profits or excess-profits taxes paid to any foreign country or possession of the United States;

"(C) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(D) Such tax, in the case of a consolidated return under section 730, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary."

(Effective under Sec. 205 of the Revenue Act of 1941, for taxable years beginning after December 30, 1940. Repealed by Sec. 105(c)(2) of the 1942 Revenue Act, effective for taxable years beginning after December 31, 1941.)

• • • •

Sec. 43 [as amended by Sec. 134 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN. The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting

upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the accrual method of accounting, amounts (except amounts includible in computing a partner's net income under section 182) accrued as deductions and credits only by reason of the death of the taxpayer shall not be allowed in computing net income for the period in which falls the date of the taxpayer's death. (26 U.S.C. 1946 ed., Sec. 43.)

Sec. 48. DEFINITIONS.

When used in this chapter—

* * * *

(c) "Paid or Incurred," "Paid or accrued."—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * *

(26 U.S.C. 1946 ed., Sec. 48.)

Sec. 122 [as added by Sec. 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [as amended by Sec. 105 (e) (3) (A) of the Revenue Act of 1942, *supra*] Definition of Net Operating Loss.—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Sec. 153(a) of the Revenue Act of 1942, *supra*] Amount of Carry-Back and Carry-Over.—

(1) Net operating loss carry-back.—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first

preceding taxable years shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * * *

(c) [as amended by Secs. 105(e)(3)(B) and 153(b) of the Revenue Act of 1942, *supra*] Amount of Net Operating Loss Deduction.—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(e));

(d) [as amended by Sec. 105(e)(3)(C) of the Revenue Act of 1942, *supra*] Exceptions, Additions, and Limitations.—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

* * * *

(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * *

(26 U.S.C. 1946 ed., Sec. 122.)

Sec. 505. SUBCHAPTER A NET INCOME.

For the purposes of this subchapter the term "Subchapter A Net Income" means the net income with the following adjustments:

(a) Additional Deductions.—There shall be allowed as deductions—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

* * * *

(26 U.S.C. 1946 ed., Sec. 505.)

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No. 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

THE UNITED STATES OF AMERICA, *Petitioner*,

v.

OLYMPIC RADIO AND TELEVISION, INC., *Respondent*

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR THE RESPONDENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 10

THE UNITED STATES OF AMERICA, *Petitioner,*

v.

OLYMPIC RADIO AND TELEVISION, INC., *Respondent*

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The original Opinion of the Court of Claims together with the dissenting opinion (R. 10-14) is reported in 108 F. Supp. 109. The supplemental Opinion with dissent (R. 16-19) is reported in 110 F. Supp. 600.

JURISDICTION

The Court of Claims' judgment was entered November 4, 1952 (R. 10, 14). The Government filed a motion for rehearing on December 3, 1952 (R. 14) which was denied in the supplemental Opinion decided March 3, 1953 (R. 16). On May 29, 1953, the Government filed a petition for

writ of certiorari which was allowed October 14, 1954 (R. 21). The Court's jurisdiction of this controversy is founded on 28 U. S. C., Section 1255(1).

QUESTION PRESENTED

In 1946, the taxpayer's deductions exceeded its gross income by $310,872.60. It paid the Collector of Internal Revenue $263,272.80 in excess profits taxes within the year 1946. Taxpayer added the latter amount to the $310,872.60 under Section 122(d)(6) of the Internal Revenue Code[1] and carried-back the aggregate of $574,145.40 to the year 1944 as a net operating loss deduction[2] in the latter year. Section 122(d)(6) required the addition of excess profits taxes "paid or accrued"[3] within 1946 to the excess of deductions over gross income in that year in determining the amount of the 1946 net operating loss. The question is: Should the taxpayer be denied the right to take into account excess profits taxes *paid* in 1946 in computing the amount of the 1946 net operating loss under Section 122 (d)(6) because: (a) it used the accrual method of accounting or because, (b) the taxpayer happened to incur a net operating loss in 1947 which, when carried back to 1945, resulted in refunds or credits to the taxpayer of the excess profits taxes for the year 1945 paid in 1946.

---

[1] Unless otherwise noted references to the "Code" or the "Internal Revenue Code" relate to the "Internal Revenue Code of 1939".

[2] There is no dispute as to the carry-back of the $310,872.60. and its allowance as a deduction in 1944; credits or refunds of a portion of the 1944 taxes were made as a result of the allowance of such a deduction. The dispute relates only to the tax effect of the additional amount of $263,270.80 included by the taxpayer in the gross amount of net operating loss claimed under Section 122 (d) (6). If allowed, the net operating loss carry-back and finally the deduction will be increased *pro tanto*.

[3] In this proceeding there is only a "paid" issue; there is no present issue involving taxes "accrued". See R. 5.

STATUTES INVOLVED

Pertinent Code Provisions are printed in full in Appendix A, pp. 47 to 60.

Provisions of certain Revenue Acts and prior Code provisions are also printed in Appendix A.

STATEMENT

This Federal tax refund suit was submitted to the Court of Claims on motions for summary judgment together with supporting affidavits filed by both parties. The undisputed facts are briefly as follows:

The taxpayer, a corporation chartered in New York State and engaged in the manufacture of radio and television receiving sets, kept its books and accounts on the accrual basis and filed its Federal corporation tax returns on the same basis, using a calendar year (R. 1, 3).

The taxpayer's Federal corporation income tax return filed for the year 1946 disclosed no tax liability, reflecting instead a net operating loss of $324,844.23. Subsequent audit of this return by the Bureau of Internal Revenue reduced this loss to $310,872.60 to which the taxpayer agreed. (R. 2, 3, 11)

As provided by statute, the loss of $310,872.60 was carried back to the year 1944 where, allowed as a net operating loss deduction in that year, it produced overpayments of tax which were credited or refunded to the taxpayer (R. 5, 11).

In the year 1946 taxpayer had paid $263,272.80 in excess profits taxes with respect to its excess profits tax liability for the year 1945 (R. 2, 9). In June, 1948, taxpayer filed a claim for refund of additional income and excess profits taxes for the year 1944 based upon the provisions of Section 122(d)(6) of the Internal Revenue Code. That claim was predicated on the contention that the taxpayer was entitled to include the sum of excess profits taxes actually paid within 1946 in determining the amount of net operat-

ing loss for 1946 and the corresponding deduction in 1944. (R. 2, 3, 11)

Failure of the Commissioner of Internal Revenue to take action with respect to said refund claim for more than six months after the filing thereof authorized the taxpayer to file petition in the United States Court of Claims on June 14, 1952 (R. 1-3). In that Court, the taxpayer abandoned some of its contentions[4] and sued for a refund of $148,841.72[5] in excess profits tax for 1944 with interest as provided by law. (R. 5, 10,14)

The Court of Claims held for the taxpayer and found that it was entitled to include the amount of excess profits taxes paid in 1946 in computing the amount of its 1946 net operating loss under the provisions of Section 122(d)(6) of the Internal Revenue Code (R. 10-14.) In so holding the Court ruled that "paid or accrued" used in that Section must be construed as permitting a deduction for excess profits taxes paid even though the taxpayer used the accrual basis. (R. 12-13, 16) The majority of the Court of Claims (with two dissents) found that this construction of Section 122(d)(6) was in accord with the clear intention of Congress (R. 10-14). On rehearing the same majority of the Court of Claims (with the same dissents) adhered to its original decision (R. 16-19).

---

[4] The abandoned contention related to an argument that $86,333.74 of excess profits tax accrued in the year 1946, arising out of the settlement of a dispute by agreement to a deficiency in excess profits tax in that amount. (R. 5, 7)

[5] This amount was based upon a "paid" theory only and is the amount stated in the petition to the Court of Claims. Actually, that amount is less than the proper amount refundable to the taxpayer on the basis of the holding by the Court of Claims. Due to an inadvertent error in the arithmetic computation of the effect of the additional deduction in 1944 the amount recoverable was understated in the petition. As recomputed by the taxpayer, the proper result in 1944 is an overpayment of excess profits tax of $116,425.80 and an overpayment of income tax of $53,729.41, or an aggregate overpayment of $170,155.21.

SUMMARY OF ARGUMENT

How should "paid or accrued" formerly appearing in Section 122(d)(6) of the Code be construed? Did the words connote accounting methods? Or did they refer to tax transactions, namely, actual tax payment, or that a liability for tax had arisen?

I

As a first method the taxpayer takes a practical approach, letting the results under the opposing theories point the way to the legislative purpose and proper construction. The taxpayer construes "paid or accrued" to refer to transactions involving either payment or the arise of a liability while the Government construes the words to refer to accounting methods. Under the Government's construction, of course, "paid" relates to a cash basis taxpayer and "accrued" relates to an accrual basis taxpayer.

Excess profits tax liabilities for 1945 were conventionally paid during the following year regardless of accounting methods. If 1945 was a profit year and was followed by a loss year then excess profits taxes would be paid in a loss year. Taxpayer regards this as the situation envisaged by Section 122(d)(6); it would apply to any taxpayer regardless of accounting methods. This is the ordinary case.

Unlike this equitable result the Government's construction results in gross discrimination against the bulk of corporate taxpayers who report on the accrual basis and favors the comparatively few cash basis taxpayers. If "paid" is confined to a method of accounting then obviously the cash basis taxpayer could pay its tax in a loss year. Conversely, an accrual basis taxpayer under identical circumstances would derive no benefit as its taxes would have accrued in the prior (tax) year and payment would be meaningless. Nor could the accrual basis taxpayer accrue an excess profits tax liability for the loss year itself. As a practical matter it was impossible to have a net operating loss under Chapter 1 (income tax) and at the same

time have an excess profits tax liability under Chapter 2. The unusual type of situation was one where a tax deficiency was contested postponing accrual and settlement occurred in a loss year. Under those circumstances an excess profits tax liability could accrue in a loss year under either party's theory. This, however, it must be emphasized was an unusual type of situation of limited applicability whereas the payment situation was ordinary for all taxpayers.

The Court below and even the Second Circuit have recognized the inequitable situation inherent in the Government's argument. This type of inequity is to be distinguished from the ordinary differences found between taxpayers arising from different accounting methods. Those disadvantages were temporary while the discrimination here was permanent. Recalling that the net operating loss provisions were essentially relief provisions designed to help taxpayers by permitting them to spread losses, it is inconceivable that Congress in that process deliberately intended to discriminate against the great bulk of corporate taxpayers in an ordinary situation. Congress must be presumed to have intended "equality among taxpayers", and only the taxpayer's transactional concept achieves such a result.

II

Congress did not define the words "paid or accrued" when used in Section 122(d)(6). The meaning of these words, however, may be gleaned by analyzing the provisions of the statute themselves, by analyzing the legislative history to determine legislative intent, and finally on the authority of a related line of cases. The foregoing sources lead to the conclusion that Section 122(d)(6) was designed to permit corporate taxpayers regardless of accounting methods to take as a deduction the amount of excess profits tax paid in a loss year in determining the amount of the net operating loss.

Of all the adjustments under Section 122(d), the (6) adjustment, the one here involved, was the only one intended to help a taxpayer where a net operating loss had been incurred. All of the others tended to reduce the amount of the loss. The (6) adjustment was the "addition" referred to in the caption of Section 122(d) as it "added to" the amount of the loss.

Although Congress used the word "deduction" in Section 122(d)(6) it is clear that the word as used there was not used in a conventional sense, as under Section 23, for example. Section 23(c)(1)(B) of the Code specifically made excess profits taxes non-deductible in determining net income in 1946. This provision had been added by the same section of the Revenue Act of 1942 which added 122(d)(6) to the Code.

Taxpayer concludes, therefore, that as a conventional deduction was not intended, Congress must have designed the adjustment to permit the "addition" of excess profits taxes either paid or accrued in the loss year to the amount of the net operating loss just as if they had been deductions for this limited purpose. This renders the Government's argument on deduction wholly inapposite.

The technique used in Section 122(d)(6), while somewhat out of the ordinary, was similar to a technique used by Congress in a number of other Code provisions in effect at the same time. The other Code provisions were those relating to foreign personal holding companies, domestic personal holding companies, improper accumulations of surplus and even the excess profits tax itself. Each of these "super-surtaxes" plugging loopholes was levied upon a tax base derived from but different from net income. Conventionally, a number of adjustments were made, differing among the various sections, to convert net income to the respective tax base concerned in each of the differing sections. In both of the personal holding company sections as well as the one involving improper accumulations of surplus, otherwise non-deductible Federal taxes were re-

quired to reduce net income under language which in each case described such taxes as "paid or accrued during the taxable year". Those cases construing these provisions such as *Commissioner* v. *Clarion Oil Company,* 148 F. (2d) 671, in the case of personal holding companies, have uniformly held that "paid or accrued" referred to transactions and not accounting methods. In each case the rationale was that accounting methods were connoted by paid or accrued under Section 48(c) only where net income was involved. Adjustments made to net income after it had been determined were not controlled by these terms which were to receive their ordinary meaning.

The parallel between these types of adjustments and that involved under 122(d)(6) is striking. In the situation here involved net loss (excess of deductions over gross income or negative net income) was to be adjusted for the "exceptions, additions and limitations" of subsection 122(d). These adjustments converted "net loss" into net operating loss. The (d)(6) adjustment, a negative type of factor, tended to increase a net loss or reduce net income. Though not a base for imposing tax it was a base for a refund of tax. The identity of language and structure used in the two situations require the conclusion that what Congress intended in the other situations it must have intended here as well.

In spite of the Government's implication that Congress "overlooked" many things in connection with Section 122(d)(6) and that, therefore, this Court should legislate what was overlooked and deny the benefit of that section to accrual basis taxpayers, it is demonstrable that Congress devoted close and detailed attention to the section. It is also clear that duplication of benefit was deliberately prevented.

Among the examples of Congressional interest in the section are:

(a) The three qualifying Rules under (d)(6) applying to widely diverse situations.

(b) The fact that a Section 26(e) credit never appeared under Section 122 where a (d)(6) adjustment was allowed. The Section 26(e) credit against net income was one allowed in the amount of income subject to excess profits tax.

(c) Adjustments under Section 122(b) involving the (d)(6) factor were in harmony with the Congressional concept that the payment of such tax was an economic loss.

(d) Sections 711(a)(1)(J) and (a)(2)(L) were restrictive provisions confining the operation of Section 122(d)(6). They indicated a Congressional consideration of the very question of double benefit and deliberately prevented it. It would be unwarranted to go beyond the limitation imposed by Congress itself without express authority.

(e) Section 26(c)(2), while incorporating the (d)(1), (2) and (3) adjustments carefully omitted the (d)(6) adjustment in a section of very narrow technical application.

It would be unreasonable to suppose that Congress drafted these complicated provisions to achieve nothing. For if paid or accrued were given the meaning the Government urges, that meaning inevitably would emasculate the section. Could Congress intend such a result?

A line of cases starting with *Commissioner* v. *Clarion Oil Co., supra*, has repeatedly held in the personal holding company context that "paid or accrued" need not necessarily refer to accounting methods as required by Section 48(e) and that where some statutory concept beyond net income was involved "paid or accrued" may receive their ordinary transactional meaning with reference to tax payments or tax accruals. This line of cases, therefore, distinguished those cases dealing with ordinary tax deductions from net income as inapposite. Three Circuit Courts, the Court of Claims, a District Court, and the Tax Court of the United States have all followed the *Clarion Oil* principle. It has recently been extended into the analogous situation

of Section 102 where a construction similar to *Clarion Oil Co.* was given. Whether personal holding company surtax or improper accumulations of surplus were involved, these similar type of adjustments, just like the (d)(6) adjustment, helped taxpayers by reducing the base for the surtax.

The legislative history of Section 122(d)(6) and related provisions reveals that paid or accrued were intended to refer to transactions and not accounting methods. Two significant omissions under Section 122(d)(6) enacted by the Revenue Act of 1942, bear this out. The two omissions were, respectively, Rule (A), formerly appearing under Section 23(c)(2) and the absence of the Section 26(e) credit.

The 1941 Revenue Act allowed excess profits taxes as a deduction in computing net income (Code Section 23(c)(2)). That allowance was qualified by four rules, the first of which placed cash basis taxpayers on the same basis as accrual basis taxpayers by considering taxes paid after a taxable year as though paid within the taxable year. When Section 122(d)(6) was enacted by the Revenue Act of 1942, Rules (B), (C) and (D) formerly under Section 23(c)(2) became Rules (A), (B) and (C) under (d)(6). Why was Rule (A) omitted?

The answer is that the rule would have been meaningless in a loss year. No tax liability could arise or be imposed in the loss year. Thus, the words "paid or accrued" could not have related to the loss year but must have related to transactions dealing with taxes of *prior* years. In any other context "paid or accrued" were inapposite.

The second omission, that relating to Section 26(e), occurred for the same reason and warrants the same conclusion. The same section of the Revenue Act of 1942 which enacted Section 122(d)(6) dealt also with credit for dividends received and computation of Section 102 net income. Each of these sections contained specific reference to the new 26(e) credit yet no reference was made

in Section 122(d)(6) with respect to that credit. Again the reason is attributable to the loss year. Where there was a loss there was no excess profits net income and hence no Section 26(e) credit. This omission likewise leads to the conclusion that "paid or accrued" related to prior year's taxes.

Committee reports indicate clearly that the purpose of the Section 122(d) adjustments, including (d)(6), was to sterilize net loss of non-economic factors and convert it into economic loss. Where the factors were used with a profit year (as in Section 122(b) or (c)) the effect was to convert net income into economic net income. These various adjustments at every stage of the computation from operating losses, through carry-back, to deduction made the connection between a (d)(6) adjustment and the final deduction very indirect. Moreover, the amount of the net operating loss deduction was derived from loss carry-overs and carry-backs from *other* years. Hence, Sections 43 and 48(e) did not apply as these items were not paid or accrued *in* the year of deduction.

In passing it should be noted that every attack made by the Government upon the taxpayer's contentions would, if valid, apply with equal vigor against a cash basis taxpayer in the identical situation and yet under the logic of the Government's theory a cash basis taxpayer who paid a tax in a loss year should benefit. Such inconsistency reveals the Government's real argument to be that it does not agree with the Congress and therefore Section 122(d)(6) should not apply to accrual basis taxpayers.

Even if it be held that "paid or accrued" technically and literally refers to methods of accounting as described in Section 48(e), then this Court should construe the quoted words in accordance with the Congressional intention already demonstrated. Where language is at odds with the purpose of the statute as demonstrated by an absurd or even unreasonable result arising from the words used, then this Court should follow the policy of the legislation as

a whole. Applying that rule here the transactional meaning should be given to paid or accrued under Section 122(d)(6).

III

The fortuitous occurrence of another loss in 1947 resulted in the taxpayer having a net operating loss carry-back to and deduction in 1945 thereby recovering for the taxpayer the excess profits taxes for that year paid in 1946. The Government cites this as showing that no economic loss resulted from the payment of tax in 1946.

This argument, also made below, was not even adverted to there.

The Government contends that only the tax as finally determined *after* carry-back was "imposed," and only the tax "imposed" could be an economic loss.

Aside from the fact that the payment of money undoubtedly was an economic loss the fact is that the original tax for 1945 was imposed. This is indicated by Section 56(a) of the Code and the rationale of *Manning* v. *Seeley Tube & Box Co., Inc.*, (1950) 338 U.S. 561.

That subsequent losses should not affect previously deducted taxes is also accepted by the Commissioner as indicated by two recent rulings.

The Government's argument tends to negative the annual accounting concept.

ARGUMENT

Introduction

The statutory provision the construction of which is in dispute is Section 122(d)(6)[6] of the Internal Revenue Code relating to net operating losses. To the extent here material that section provided:

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[6] This section of the Code has no present application. Enacted by the Revenue Act of 1942, it was never repealed but was simply made inapplicable with respect to any taxable years ending after June 30, 1950. See Section 304 (c) of the Excess Profits Tax Act of 1950.

> "There shall be allowed as a deduction the amount of tax imposed by subchapter E of Chapter 2[7] paid or accrued within the taxable year, * * *."

More specifically, the dispute centers about the words "paid or accrued." The problem is to determine the proper connotation of the quoted words when read in conjunction with Section 122(a) of the Code which defined the net operating loss to be:

> "* * * the excess of the deductions allowed by this Chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)."

The taxpayer's position is that the words "paid or accrued" were disjunctives referring to tax transactions. The terms connoted respectively either the discharge of a liability for tax by payment or that a liability for tax had arisen.[8] These were the ordinary and usual meanings of these words. Inasmuch as the taxpayer actually "paid" or discharged its 1945 excess profits tax liability during the loss year 1946, it follows that under the statute the amount of such payment should be allowed as a deduction in computing the amount of net operating loss.

The Government reads the two words together and interprets "paid or accrued" to distinguish between taxpayers' methods of accounting. That is, "paid" refers to a payment if a taxpayer was on a cash receipts and disbursements basis and "accrued" refers to an accrual if a taxpayer was on the accrual basis. The Government argues that because the taxpayer was on the accrual basis it could not take into account the excess profits tax admittedly paid in 1946 because it had "accrued" in 1945.

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[7] Subchapter E of Chapter 2 related to excess profits tax.

[8] To distinguish the taxpayer's conceptual approach from that of the Government, the taxpayer's meanings may be regarded as "transactional" in nature while the Government adheres to an "accounting method" theory.

The taxpayer's position is supported in principle and reasoning by the language of the statute itself, by an analogous line of authority and is confirmed by the Congressional intent as manifested through the legislative history of the disputed section and related provisions.

I.

Only the Transactional Meaning of "Paid or Accrued" Permits Fair and Equal Treatment of All Corporate Taxpayers Regardless of Accounting Methods, as Intended by Congress

Before probing legislative history to discover Congressional intent, the nature of the problem suggests a practical approach; let the results under the opposing theories point the way to the legislative purpose and the proper construction. The taxpayer reads "paid or accrued" in the ordinary[9] or "transactional" sense while the Government construes "accounting methods." What are the practical effects of these opposed arguments? First the usual situation.

In the year 1945, every corporate[10] taxpayer was required to pay its excess profits tax in full on the fifteenth day of the third month following the close of its taxable year or in four quarterly installments during the year following the taxable year.[11] This was the usual or conventional way

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[9] In addition to the holding of the Court below on this point, a similar rule appears in a number of cases involving personal holding company situations. See *Commissioner* v. *Clarion Oil Co.* (CCA DC, 1945) 148 F. (2d) 671, 677; cert. den. 325 U. S. 881; *Birmingham et al., Exrs.* v. *The Loetscher Company* (CCA-8, 1951) 188 F. (2d) 78, 79; *Aramo-Stiftung* v. *Commissioner* (CCA-2, 1949) 172 F. (2d) 896, 897; *Wm. J. Lemp Brewing Co.* (1952) 18 T.C. 586, 600 and 601. The same rule also has been adopted in another situation, namely, improper accumulations of surplus arising under Chapter 1. See *Harry M. Stevens, Inc.* v. *Johnson* (DC SD NY, 1953) 115 F. Supp. 310, 312, (now pending before CCA-2).

[10] The excess profits tax imposed by Section 710 of the Code was levied only upon corporations.

[11] Sections 56 (a) and (b) of the Code.

in which corporate taxpayers liquidated tax return liabilities and this was so *regardless of accounting methods.*

Where a corporate taxpayer had a profit year in which it incurred an excess profits tax liability and the year following was a year of loss, then the excess profits tax liability for the profit year was routinely discharged by payment in the loss year. Under such circumstances, whether the taxpayer was on the cash or the accrual method of accounting, it met the requirements of Section 122(d)(6) under the taxpayer's theory. It had "paid" an excess profits tax within a loss year.

The "accounting method" sense the Government would place upon the words "paid or accrued," unlike this equitable result, produces a gross discrimination against the many accrual basis taxpayers and in favor of the few cash basis[12] taxpayers. A cash basis taxpayer, conventionally paying its liability for excess profits taxes in a loss year following a profit year, would obviously benefit under Section 122(d)(6). Its cash basis of accounting would recognize the payment as a "disbursement." In contrast, an accrual basis taxpayer *under identical circumstances* necessarily would be denied the benefit of the adjustment, under the Government's theory. For it, the taxes would have "accrued" in the year imposed and payment in the later year would have no effect under Section 122(d)(6).

Nor could the accrual basis taxpayer qualify under the Government's theory for an accrual in a loss year itself. To do so an accrual basis taxpayer would have had to incur an excess profits tax liability under Chapter 2 in a given year (based on taxable excess profits net income) and at the same time and for the same year incur a net operating loss (a negative net income figure) under Chapter 1. To state this is to indicate the answer. Ordinarily,

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[12] It is a commonly accepted truism that the great bulk of corporate taxpayers utilized the accrual method of accounting rather than the cash receipts and disbursements method.

therefore, it was obviously impossible to accrue both an excess profits tax liability and a net operating loss in the same year. The necessary result is that under the Government's theory the cash basis taxpayer could under ordinary circumstances qualify under Section 122(d)(6) while the much more significant class of corporate taxpayers—accrual basis—would automatically be disqualified. As to them, the benefits of the section would be "largely illusory." (See opinion below.)

There was also an unusual type of situation. Where liability for an additional (deficiency) tax was contested, such a contest would postpone the accrual of such a tax liability under well-recognized principles.[13] Termination of the dispute would fix the time of accrual and this could occur in a loss year.[14] Under such circumstances an excess profits tax liability "accrued" benefiting equally the cash or the accrual basis taxpayer under Section 122(d)(6).[15]

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[13] *Dixie Pine Products Co.* v. *Commissioner* (1944) 320 U. S. 516; at 519; *Security Flour Mills Co.* v. *Commissioner* (1944) 321 U. S. 281, 284-6.

[14] See *G.C.M. 25298*, 1947-2 Cum. Bull., 39, 43. Compare *Robert Reis & Co.* (1953) 20 T.C. 294, where an accrual basis taxpayer had a dispute as to deficiencies, there was a consequent postponement of accrual and finally *settlement and payment.* The latter two events both occurred in the loss year and both factors were cited by the Court. Under either party's theory here, the taxpayer should have prevailed in the *Reis* case.

[15] It must be emphasized again, however, that the accrual case was an *unusual* type of situation. It is described as unusual to distinguish it from the situation where taxes were paid on liabilities reflected on returns. The latter were the more usual and much more important category. Dollarwise, collections of additional taxes are not nearly as significant as tax collections based on return liabilities. For example, the *Annual Report of the Commissioner of Internal Revenue* for the fiscal year ending June 30, 1953 discloses on page 4 that corporate income and profits taxes collected for that fiscal year aggregated $21.6 *billions* (789,984 returns filed—p. 6). In the same fiscal year additional corporate income and profits taxes including interest and penalties assessed as a

This would be so under either theory. The Government cites this rare situation to show that its theory is not entirely inequitable. Note, however, that even this situation involved a discrimination favoring taxpayers with tax troubles over those without them.

The Court of Claims below recognized the force of the inequities inherent in the strained construction of the Government, particularly in the usual situation. Therefore, it rejected the Government's argument in favor of the taxpayer, convinced as it was of the intentions of Congress in this regard. (R. 12, 13.) Even the Second Circuit Court of Appeals in the companion case of *Lewyt Corporation* v. *Commissioner*, 215 F. (2d) 518 at 526, candidly recognized the force of this argument although it refused to act upon it.[16]

The inequitable and discriminatory results inherent in the Government's theory must be distinguished from that type of inevitable difference in tax effect occurring where,

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direct result of audit aggregated only $386 *millions* as shown on page 27 of the Report, or approximately 1.79 percent of the total (corporate returns examined totaled 110,996—p. 9). A similar Report for the fiscal year ending June 30, 1946 discloses total corporate tax collections of $7,822,488,154 on page 20 thereof. Additional assessments of corporate taxes for that year were not published but the taxpayer was advised by the office of the Commissioner of Internal Revenue on February 10, 1955 that additional corporate taxes assessed had aggregated $274,546,554 or less than 3 percent of the total. The conclusion seems inescapable that in comparison with total tax payments deficiency payments were comparatively very small. The Section 721 type of situation also cited by the Government was even rarer.

[16] The Second Circuit recognizing these equities, nevertheless, felt bound by the supposed mandate of Section 48 (c). That Section defined "paid or accrued" (where the computation of *net income* was involved) to refer to methods of accounting. As later demonstrated, Section 48 (c) does *not* control in the case of the Section 122 (d) (6) adjustment. Neither net income nor its negative equivalent (net loss) were directly involved; economic loss was the result of the adjustment.

due to accounting method used, a taxpayer was at a temporary disadvantage.[17] This is a situation where in the course of corporate operations losses were admittedly incurred. Congress in its plenary taxing power afforded relief[18] to taxpayers incurring losses by permitting them to spread the tax effect of such losses over adjacent years.[19] What the

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[17] The latter usually occurred in transition periods—for example when excess profits taxes were repealed in 1945 the accrual basis taxpayer was taxed on sales accruals not actually received until after repeal, while the cash basis taxpayer escaped high taxes on comparable income. The discrimination inherent in the Government's theory, on the other hand, always existed and always worked against the same class of taxpayer.

[18] In a very real sense Section 122 (d) (6) was a war relief measure. At the time the Revenue Act of 1942 was enacted many corporations not in war production were already experiencing declining profits and at the close of the war economy many other corporations were expected to experience declining profits. The provisions of Section 122 afforded in effect the same type of relief in periods of declining profits which the two-year carry-forward provisions afforded in periods of increasing profits. *5 Mertens, Law of Federal Income Taxation*, 1953 Ed., pp. 358-539.

During the war economy many normally deductible expenses were held down to a bare minimum by priorities, rationing, labor shortages and other factors beyond the control of the taxpayer. See Report No. 1631 of the Senate Finance Committee, 77th Cong., 2d Sess., p. 52. This situation was heightened by the operation of the excess profits tax law, which, because of the inability of taxpayers to take deductions for normal repairs and replacements would cause excessive net income which would be taxed as excess profits at a very high rate. *Mertens, Ibid.* See also *Diamond A Cattle Co.* (1953) 21 T.C. 1 at 7.

[19] The net operating loss deduction provision in taxing statutes and under the Code has had a checkered career. "In all its variations it has represented a response of Congress to the hardships caused by the taxable year as the measuring unit of time for determining tax liability, and in its inception in 1919 and its revival in 1939 was intended to favor taxpayers whose income was apt to fluctuate from year to year as well as those taxpayers whose business was in a period of development." *Mertens, Ibid.*, p. 355.

Government suggests was a deliberate Congressional intent to discriminate against the great bulk of corporate taxpayers in that process. It should require the most unequivocal expression of Congressional intent to justify a deviation from the ordinary meaning of "paid or accrued" to warrant such a position. A somewhat similar attempt by the Government to attribute to the Congress an intent to discriminate[20] against cash basis taxpayers was rejected in *Commissioner* v. *Clarion Oil Company*, 148 F. (2d) 671, where it was said (at p. 676):

> "Nor did Congress intend that the taxpayer on an accrual basis who entered in his books an arbitrary amount as a 'reserve for taxes' should be in a better position than the taxpayer on a cash basis, * * *."

Congress must be presumed to have intended "equality among taxpayers."[21] The taxpayer's interpretation of the disputed phrase results in fair and equal treatment of corporate taxpayers regardless of accounting methods; the theory of the Government renders the section virtually inoperative for accrual basis taxpayers. Only the taxpayer's interpretation can be in harmony with the presumed purpose of Congress.

II.

Section 122(d)(6) Was Designed (Among Other Things) to Allow Corporate Taxpayers, Regardless of Accounting Methods, to take as a Deduction the Amount of Excess Profits Tax Actually Paid In A Loss Year in Determining the Amount of a Net Operating Loss.

It must be emphasized at the outset that Section 122(d)(6) applied if, and only if, a taxpayer incurred a net operating loss; where a taxpayer enjoyed profit years the

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[20] That the purpose of a taxing statute would be frustrated by denial of equal tax treatment because of mere difference in accounting is also indicated by *Commissioner* v. *The Hecht Co.* (CCA-4, 1947) 163 F. (2d) 194, 196 and 199.

[21] *Colgate-Palmolive-Peet Co.* v. *U. S.* (1943) 320 U. S. 422, 425.

section did not apply. The provision involved, therefore, a limited type of situation.

Congress did not define in the staute or in its Reports the meaning of the terms "paid or accrued" when used in Section 122(d)(6).[22] Their meaning must, therefore, be gleaned from an analysis of the words of the statute itself in the light of the legislative purpose as disclosed by the legislative history and corroborated by a collateral line of cases involving a similar principle in a similar type situation.

A. The language of the Code itself proves this by necessary inference.

1. Section 122(d)(6) provided the principal adjustment which could benefit a taxpayer in a loss situation.

Section 122 was captioned, "Net Operating Loss Deduction." Subsection (a) thereof defined a net operating *loss;* subsection (b) described how to convert a net operating loss into a net operating loss carry-back or carry-over and how to determine the amounts thereof; subsection (c) provided rules for converting the carry-backs and carry-overs into a net operating loss deduction and for determining the amount thereof.[23] Sub-section (d) was captioned, "Exceptions, additions and limitations" and was not designed to stand alone. It merely tabulated six adjustments various of which were specifically referred to by subsections (a), (b) and (c). Section 122(a) referred broadly to all the exceptions, additions and limitations

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[22] The words were "ambiguous" as they were capable of being understood in either of two or more possible senses. See *Webster's New International Dictionary,* 2nd Ed. (1940) p. 81.

[23] This was the "plainly established trichotomy" referred to in *Reo Motors, Inc.* v. *Commissioner* (1950) 338 U. S. 442 at 446-447. The case is otherwise not in point. It stands for the rule that "net operating loss" must be determined under the law in effect in the loss year, not the law in effect in the year of the net operating loss *deduction.*

provided in subsection (d). Section 122(b) and its various subparagraphs referred only to adjustments numbered (1), (2), (4) and (6). Section 122(c) referred only to adjustments (1), (2) (3) and (4). Only subsections (a) and (b), therefore, involved the (d)(6) adjustment.

Of the six adjustments listed under section 122(d), four of them—numbers (1), (3), (4) and (5)—either eliminated or reduced specific deductions claimed on returns. One of them—(d)(2)—required the inclusion of tax-exempt interest income less non-deductible interest on debts incurred to buy tax-exempt obligations. The first five adjustments[24] together constituted the "exceptions" and "limitations" re-

[24] The first five adjustments provided as follows:

"(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114(b), (2), (3), or (4);

"(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23(b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

"(3) No net operating loss deduction shall be allowed;

"(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains."

"(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection."

ferred to in the caption. The sixth adjustment—the one here involved—allowed as a deduction the amount of excess profits tax imposed paid or accrued within the taxable year. This adjustment was the "addition" [25] referred to in the caption of Section 122(d) because it allowed an amount not deductible[26] on a return to be "added to" the excess of deductions over gross income.[27]

Of all the adjustments under (d), number (6) here involved was the *only one beneficial* to taxpayers once a loss had been incurred.[28] It tended to increase that loss by providing an additional deduction, thereby increasing the amount of the carry-back and the net operating loss deduction. This, of course, could result in a refund of overpayments for a prior year.

2. The excess profits tax paid under Section 122(d)(6) was not a *conventional* deduction under Section 23; therefore "paid or accrued" did not necessarily refer to accounting methods and Section 48(c) was inapposite. A question arises as to the exact significance of the phrase appearing in Section 122(d)(6), "there shall be allowed as

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[25] Note that the word "additions" was added to the caption of Section 122(d) by the same section of 1942 Revenue Act which enacted Section 122(d)(6).

[26] As subsequently explained, excess profits tax could not be deducted in computing corporate net income per return in 1946.

[27] The simple excess of deductions over gross income referred to in Section 122(a) was not named in the Code. It may be referred to by the non-technical term "net loss" to distinguish it from "net operating loss" which contained in addition the adjustments provided in subsection (d).

[28] This is not surprising in view of the fact that the (d)(6) adjustment was a statutory descendant of former Section 23(c)(2). Congressional benevolence which formerly had permitted a deduction under that section for excess profits tax had, by the 1942 Revenue Act, discontinued the deduction for technical reasons and allowed instead the Section 122(d)(6) adjustment and a Section 26(e) credit. These two did not duplicate but rather tended to complement each other; one applying in loss and the other in profit years.

a deduction," with reference to excess profits tax "paid or accrued." The Government contends that this language required that the adjustment for excess profits tax paid or accrued be regarded as a conventional deduction, subject to the usual rules of statutory construction. *Yet Section 23(c)(1)(B) specifically excepted excess profits tax paid or accrued from those which were deductible generally in 1946.* Excess profits tax was placed among the *exceptions* by the identical section of the Revenue Act of 1942 which added Section 122(d)(6) to the Code.[29]

The taxpayer concludes, therefore, that Congress could not have intended the word "deduction" in Section 122(d)(6) to be the conventional, Section 23,[30] type of deduction.

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[29] Section 105(d) of the Revenue Act of 1942 amended Section 23(c)(1)(B) of the Code by adding excess profits tax to the non-deductible ones. Section 105(e)(3) added subparagraph (6) to subsection 122(d) of the Code.

[30] This is expressly demonstrated by the following situation. Under Section 102(d)(1)(A), net income was required to be reduced by "excess profits taxes * * * paid or accrued during the taxable year, to the extent not allowed as a deduction by Section 23". In the absence of a saving clause, this language obviously would have included taxes under Chapter 2E which were not allowed as a deduction by Section 23(c)(1)(B). Therefore, to accomplish Congress' purpose of non-deductibility of Chapter 2E tax under Section 102, a parenthetic phrase appeared after the word "taxes" quoted above, couched in the following language:

> "(other than the tax imposed by Subchapter E of Chapter 2 for a taxable year beginning after December 31, 1940)".

This illustrates that taxes under Chapter 2E were *not* Section 23 "deductions" otherwise there was no need for the words in parenthesis.

Compare the situation under Section 505(a)(1) where net income was also required to be reduced by "excess profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under Section 23". Here, no parenthetic exception appeared and Chapter 2E taxes were, therefore, proper adjustments.

What may have been intended was that "the *amount*[31] of tax imposed" (either paid or accrued) should be "added to" the excess of deductions over gross income thereby tending to increase the amount of the net operating loss just as if it actually had been an additional deduction for this limited purpose.[32] The fact that conventional Section 23 "deductions" were *not* involved renders the Government's Argument I aside from the point. Sections 41, 43 and 48(c) are inapposite, therefore, as are the cases cited on pp. 13-14 of the Government's Brief. "Paid or accrued," therefore, were not controlled by these sections. This is not to deny, of course, that *conventional* deductions should be treated as the Government argues.

3. Other sections of the Code reveal a well-established Congressional technique of making tax "paid or accrued" adjustments *to* net income not controlled by Section 48(c). While somewhat out of the ordinary, the adjustments provided by Section 122(d) to be made to Section 122(a) bore a family resemblance to several other Code provisions in effect in mid-1940. Among such cousins were Sections 102(d)(1), 336(a), 505(a) and 711(a)(1) and (2). Although these sections related to such dissimilar corporate loopholes as improper accumulation of surplus, foreign and do-

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[31] Perhaps this was Congress' way of permitting the adjustment under Section 122(d)(6) even though excess profits taxes were technically non-deductible. That is, only the "amount" of tax imposed was allowed to be "added" to the loss; the tax itself was not to be deducted. Whatever the rationalization, the non-deductibility is clear.

[32] The Court below felt that it would have to make an exception to the general rule prohibiting "shifting" from one method of accounting to another to "give effect to the plain intention of Congress". The taxpayer believes that such intent can be given effect without taking that position, simply by relying on the distinction here noted. This also disposes of the Government's suggestion that taxpayer is inconsistently seeking to shift some but not all of its operations to a cash basis. Bases of accounting have no place in this problem.

mestic personal holding companies and excess profits, they did have a common feature. This was the fact that each related to a "super-surtax" [33] or a tax imposed above and beyond normal taxes. In each case, the base upon which the "surtax" was levied was not ordinary net income but a different statutory concept above and beyond net income.[34]

Various adjustments were specified in the respective sections to convert net income in each case to the new base for tax. The adjustments themselves tended to differ between sections depending upon considerations germane to the particular legislative purpose in each case. Yet one similar type of adjustment was found in both of the personal holding company sections as well as Section 102. It was for Federal taxes paid or accrued.

In these three sections, otherwise non-deductible Federal taxes were allowed to *reduce* net income (the personal holding company provisions referred to "additional deductions" and Section 102 used a "minus"). And in each instance the taxes were described as "paid or accrued during the taxable year". In every case construing these provisions[35] it has been held uniformly that "paid or accrued" referred to transactions, not accounting methods; a tax base beyond net income was being computed and Section 48(c) did not apply.

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[33] See *7A Mertens, supra*, (1943 Ed.) 5 *et seq.* The term is Mertens'. He lists, in addition to those named, the declared value excess profits tax, the unjust enrichment tax and the tax on excess profits on Navy contracts.

[34] The respective terms were:

Section 102(d)(1)—net income into "section 102 net income"

Section 336—net income into "Supplement P net income"

Section 505—net income into "Subchapter A net income"

Section 711(a)—normal tax net income into excess profits net income

[35] Section 102(d)(1) was thus construed in *Harry M. Stevens, Inc.* v. *Johnson, supra.*

Section 505(a)(1) was construed in *Wm. J. Lemp Brewing Co., supra, Aramo-Stiftung* v. *Commissioner, supra*, and *Birmingham* v. *The Loetscher Company, supra.*

The parallel between these provisions and Section 122(a) and (d)(6) is striking. Net loss (excess of deductions over gross income—negative net income) under Section 122(a) had to be adjusted for the "exceptions, additions and limitations" provided in subsection 122(d). These adjustments converted "net loss" into "net operating loss". The (d)(6) adjustment was a deduction for excess profits taxes "paid or accrued within the taxable year." As a negative (or deduction) factor it tended to *reduce* net income or, in a loss year, *increase* net loss. While the "net operating loss" was not a base for a surtax it was a negative base for the negative of tax—a refund (from carry-back and deduction).

From the foregoing, it is discernible why Congress used the technique it did in Section 122; from 1934[36] to the present time[37] Congress has used the type of device described. It is not surprising therefore, that Congress, in legislating on a matter involving payment or accrual of a non-deductible excess profits tax (a super-surtax itself), should follow its own pattern and adopt almost identical language used before appropriately adapted, however, to the requirements of a loss rather than a surtax situation. The Congressional intent in using "paid or accrued" in the similar provisions was firmly established. What was intended there must have been intended here.

4. Congress quite apparently devoted a considerable amount of time and attention in drafting detailed provisions regulating the implications and ramifications of Section 122(d)(6) and to avoid duplication of benefit to taxpayers by that provision; any further restriction by Courts

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[36] See Section 351(b)(1)(A) of the Revenue Act of 1934 relating to personal holding company "adjusted net income."

[37] See Section 545(b)(1) of the Internal Revenue Code of 1954 where, in a personal holding company situation, certain excess profits taxes are allowed as a deduction from "taxable income" when paid (if previously reported on a "when paid" basis) unless by irrevocable election they are to be reported hereafter when "accrued."

through a narrower construction of "paid or accrued" than intended by Congress would be unwarranted.

The general flavor of the Government's Brief is that the Congress "overlooked" a lot of things in connection with Section 122(d)(6). The facts are to the contrary. The implication, however, is that this Court should legislate that which was overlooked and, presumably, hold the Section inapplicable to accrual basis taxpayers (with rare exceptions).

The following examples from the Code of detailed Congressional interest in Section 122(d)(6) may be cited:

(a) Congress provided three qualifying rules under (d)(6) dealing with matters as diverse as allowance of the full amount of excess profits tax paid unreduced by the foreign tax credit, the non-applicability of a technical loophole-plugging provision involving adjustments in the case of inconsistent positions and allocation of tax in the case of a consolidated return;

(b) Wherever the (d)(6) adjustment was referred to in Section 122 no reference was made to a Section 26(e) credit (for example, subsections (a), (b) and (d)); conversely, where reference to the Section 26(e) credit was made, the (d)(6) adjustment did not appear (as in Section 122(c)). The (d)(6) adjustment, therefore, was to apply in such a way that there would be no duplication of benefits[38] by having a Section 26(e) credit allowed in the same year;

(c) Sections 122(b)(1)(A) and (b)(2)(A),[39] allowed the

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[38] Wherever there was a Section 26(e) credit, that indicated a profit year, such as the year of *deduction* of a net operating loss. In a loss year under 122(a) there could be no Section 26(e) credit (there being no adjusted excess profits net income). Even under Section 122(b)(1) where the (d)(6) adjustment occurred in a profit year (second year preceding the loss year) *only* the (d)(6) adjustment was allowed and not the Section 26(e) credit.

[39] These sections related to the net operating loss carry-back and carry-over types of situation. For example, in determining the amount of the carry-back to the year *first* preceding the year of

(d)(6) adjustment in harmony with the Congressional concept that payment of an excess profits tax was an "economic loss";

(d) The insertion of Sections 711(a)(1)(J) and (a)(2)(L) in the Code (by the 1942 Revenue Act) indicated Congressional preoccupation with the area of impact of Section 122(d)(6) and further indicated a deliberate attempt to curtail its operation. It would be unwarranted, therefore, to go beyond the limits Congress itself placed on the section[40] and add a significantly greater limitation by applying Section 48(c);

(e) Section 26(c)(2) carefully avoided an adjustment comparable to Section 122(d)(6) (although adopting the (d)(1), (2) and (3) adjustments) in a section of very narrow application controlling net operating loss carry-over credits in matters relating to Section 102 net income, Supplement P net income and Subchapter A net income.

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loss, the net operating loss had subtracted *from it* the net income of the *second* preceding year after it had been adjusted for the 122(d)(1), (2), (4) and (6) factors. As the payment (or accrual but not *both*) of an excess profits tax in the second year preceding the loss year was an economic loss in that year, the statute permitted the amount of such payment (or accrual) to *reduce* net income at that time thereby *increasing pro tanto* the amount of the carry-back "overflow" to the year first preceding the loss year.

[40] It may be noted that while Section 122(d)(6) was a part of the original 1942 Revenue Bill as originally introduced in the House, the subsections of 711 referred to were first introduced as Senate floor amendments and were in turn amended by the Conference Committee. These provisions had been suggested by the Congressional legislative drafting staff and had been submitted to the Treasury where they had been approved. Apparently, they were inserted solely for the purpose of eliminating duplications and other imperfections in the net operating loss carry-over provisions as they applied to the computation of excess profits net income. See 88 *Congressional Record* 8015—discussion by Mr. George: H. R. No. 2586, 77th Cong., 2d Sess., Amendment No. 291

It scarcely seems reasonable to suppose that the Congress drafted these complicated provisions using "paid or accrued" in an accounting sense in Section 122(d)(6) which would have the inevitable effect of virtually emasculating that section and the other mentioned. Yet that is what Congress intended, the Government insists[41]).

B. The Clarion Oil Company line of cases has established the rule: "Paid or accrued" may have different meanings under the Code; where necessary to produce a new statutory concept beyond net income these words may be given their ordinary meaning and not that of Section 48(c).

The *Clarion Oil* case, 148 F. (2d) 671, involved a cash basis taxpayer which paid its 1937 income and excess profits taxes in 1938. The question involved was the taxpayer's right to compute its "undistributed net income" for 1937 by subtracting from its net income for that year the amounts of income and excess profits taxes which "accrued" in 1937 but which were "paid" in 1938. The United States Court of Appeals for the District of Columbia refused to follow the Tax Court in holding that the word "accrued" had to be construed with reference to the manner in which the taxpayer kept its accounts; it held that accounting methods were connoted by the terms "paid or accrued" *only when* net income was being determined. Speaking with reference to the definition of "paid or accrued" used in Section 48(c) (also relied on in this case by the Government) the Court of Appeals said at 675:

> "But obviously, this definition was intended to apply to the method of computing *net income*, and has no

[41] The Government's construction of the disputed words suggests analogy to the classical: "When I use a word," Humpty-Dumpty said, "it means just what I choose it to mean—neither more nor less." *Through the Looking Glass and What Alice Found There*, "Lewis Carroll."

> reference or relevancy to the subject matter of what, for the purpose of the newly added provision in relation to personal holding companies, is taxable as undistributed income.[14] In other words, having determined 'net income' in accordance with the accounting methods of the taxpayer, there is no need to question whether an ordinary income tax was 'paid' or whether it was 'accrued', since in either event it was a deductible item and no longer represented accumulations of income, which it was the intent of this tax to force out of the 'incorporated pocketbook' and into the hands of individual taxpayers." (Emphasis in the original.)

Footnote 14 referred to in the quote held that cases dealing with the deduction of Federal taxes for purposes of "net income" were inapposite, citing as an example *U. S.* v. *Anderson* (1926), 269 U.S. 422. This case and related cases relied on by the Government there (p. 14 of its Brief) are inapposite for the reason indicated.

In discussing the inapplicability of the taxpayer's method of accounting the Court pointed out in *Clarion* that it was enough if the taxes were *either* paid *or* accrued in the taxable year. There was absent the administrative need for uniformity in computing "undistributed net income" (under Section 356(a)(1) of the Revenue Act of 1937) which was essential in the computation of net income.

The Eighth Circuit,[42] the Second Circuit,[43] the Court of Claims,[44] a District Court,[45] and the Tax Court[46] have all agreed with and followed the rationale of the *Clarion Oil* case in construing Section 48(c).

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[42] *Birmingham et al., Exrs.* v. *The Loetscher Company*, 188 F. (2d) 78 at 79.

[43] *Aramo-Stiftung* v. *Commissioner*, 172 F. (2d) 896 at 897.

[44] This case in the court below.

[45] *Reliance Feed & Grain Co., Inc.* v. *Shaughnessy* (DC ND NY, 1949) 84 Fed. Supp. 389 at 390.

[46] *Wm. J. Lemp Brewing Co.*, 18 T.C. 586 at 608.

That construction also has been extended in a recent case[47] to Section 102(d)(1)(A) of the Code involving adjustments to net income to produce "Section 102 net income" by deducting *inter alia* Federal income tax "paid or accrued during the taxable year * * *."

It is true, of course, that Section 122 was a relief provision tending to favor taxpayers by virtue of allowance of net operating loss deductions while the *Clarion Oil* case involved the personal holding company penalty surtax. However, in both situations the adjustments themselves were favorable to taxpayers[48] and there was, moreover, the conceptual affinity of the way in which the adjustments were made. In both cases adjustments were made after the "administrative need for uniformity" had already been satisfied.

The *Clarion Oil* case by analogy also supports the taxpayer's position that adjustments *to* (not deductions used in computing) net loss produced a new statutory concept notably dissimilar—net operating loss. In *Clarion* the new concept was "undistributed net income"; here it was "net operating loss". There the purpose of the adjustments was to create a fair base for a penalty surtax; here the purpose was to create economic loss to be carried back.

C. As disclosed by the legislative history the Congressional intent in using the phrase "paid or accrued" in Section 122(d)(6) was to refer to transactions, not accounting methods.

1. The Revenue Act of 1942 made two significant omissions under Section 122(d)(6), both indicating that Congress referred to *taxes of other years* when it used "paid or accrued" and, therefore, did not intend to refer to

[47] *Harry M. Stevens, Inc.* v. *Johnson*, 115 Fed. Supp. 310 at 312.

[48] The Section 122(d)(6) adjustment tend to *increase* the amount of a net operating *loss* and hence the amount of the carry-back and resulting deduction. In the case of the penalty surtax the adjustment *reduced* the tax base subject to the penalty tax.

accounting methods. These omissions were, respectively, the non-appearance of Rule (A) which had formerly qualified Section 23(c)(2) in a related situation and the absence of the Section 26(e) credit.

Of what significance was the omission of Rule (A)? Congress first enacted an excess profits tax in the general period here under consideration when it passed the Second Revenue Act of 1940 adding Subchapter E to Chapter 2 of the Internal Revenue Code. This Act was approved October 8, 1940, and applied to taxable years beginning after December 31, 1939. For 1940, Section 23(c) of the Internal Revenue Code as it then read permitted a direct deduction of taxes paid or accrued[49] within the taxable year (with certain exceptions) in determining net income. Included among the exceptions were the Chapter 2E excess profits taxes.[50]

Section 202(a) of the Revenue Act of 1941 (approved September 20, 1941) removed excess profits taxes (under Chapter 2E) from the list of exceptions to the general deduction rule and simultaneously added new subparagraph 2 to Section 23(c) which specifically permitted a direct deduction of imposed excess profits taxes in computing net income, subject however to four limiting rules. These provisions were effective as to taxable years beginning after December 31, 1940 or later years. Rule (A) of subparagraph 2 of Section 23(c) effectively placed all taxpayers on the accrual basis of accounting with respect to the excess profits tax payments for a taxable year. Rule (A) read:

> "The deduction shall be limited to the tax imposed for the taxable year but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year; * * *."

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[49] In this context "paid or accrued" admittedly related to accounting methods.

[50] See Section 506(b) of the Second Revenue Act of 1940 amending Code Section 23(c)(1).

The Revenue Act of 1942[51] (approved October 21, 1942), by Section 105(c) thereof, repealed Section 23(c)(2) of the Code and simultaneously restored excess profits taxes to the list of exceptions to the deduction rule. The very same section[52] of the 1942 Revenue Act which restored excess profits to the list of exceptions to the tax deduction provisions added the new provision—Section 122(d)(6)—to the Internal Revenue Code. Pertinent language in the Senate Report[53] was as follows:

> "Section 122 of the Code relating to computation of the net operating loss deduction allowed by section 23(s) of the Code, is amended so as to *allow* the excess profits taxes paid or accrued within taxable years (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carry-over and carry-back from, such taxable years."[54] (Emphasis supplied)

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[51] This Act effected a major revision of the tax laws during the war period. Of importance here is the fact that it altered significantly the method of computing excess profits tax liability. Prior thereto the excess profits tax had been computed like an additional surtax and had been reflected on the income tax return form. Under the new act, separate tax bases were provided for the computation of the two taxes, the so-called "two-basket" principle. See H. R. No. 2333, 77th Cong., 2d Sess., p. 18.

[52] Section 105.

[53] No. 1631, 77th Cong., 2d Sess., p. 67; see also H. R. No. 2333, 77th Cong., 2d Sess., p. 65.

[54] It may be observed that this language indicated a clear intention to *allow* the adjustment enacted as Section 122(d)(6). This emphasis should be unnecessary but in view of the impression given by the Government Brief it must be made. That Brief implies that Congress wrote the section to *disallow* the adjustment. See Argument I and I.A.

Rules (A), (B) and (C) qualifying Section 122(d)(6) were almost verbatim copies of Rules (B), (C) and (D) formerly appearing in Section 23(c)(2).[55] Significantly, Rule (A) which had appeared under Section 23(c)(2) did not reappear under Section 122(d)(6). This was the rule which had effectively placed all taxpayers on the accrual basis with respect to excess profits tax *payments*.

Recalling that the professed purpose of Congress in enacting Rule (A) under Section 23(c)(2) had been to accord all taxpayers, cash and accrual, the *same treatment*[56] with respect to the deduction of payments for excess profits tax, a question arises as to the significance of the apparently deliberate omission of Rule (A) from Section 122(d)(6). Maxims[57] of judicial construction suggest that the deliberate omission of Rule (A) indicates as a minimum that Congress did *not* thereby intend to have all taxpayers on the accrual basis under Section 122(d)(6) as they had been under Section 23(c)(2).

Another conclusion also seems warranted. As Congress intended in 1941 to accord both cash and accrual taxpayers the *same* treatment with respect to the adjustment for excess profits tax, it can scarcely be supposed that Congress by the enactment in 1942 of Section 122(d)(6) omitting Rule (A) intended to accord cash and accrual taxpayers a *dissimilar* treatment simply because of a change in the base for corporate tax. Certainly it should require a clear expression of intent to warrant a conclusion that

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[55] A word-by-word comparison of the related rules leads to the conclusion that the legislative draftsmen must have had the prior language before them in drafting the rules under Section 122(d)(6).

[56] This was flatly stated in H. R. No. 1040, 77th Cong., 1st Sess., p. 46 and S. R. No. 673 (Part 1) 77th Cong., 1st Sess., p. 37.

[57] *Inclusio unius est exclusio alterius*, for example.

Congress was abandoning equality[58] for discrimination, and the taxpayer can find none.

This much seems self-evident. What more may be inferred? The answer is found by considering the effect of Rule (A) *if* it had been enacted under Section 122(d)(6). That Rule under Section 23(c)(2) required a cash basis taxpayer to consider an excess profits tax paid *after* a taxable year as having been paid within the taxable year, the deduction being limited to the tax imposed in a profit year. This placed the cash and accrual basis taxpayers upon the same exact footing. While such a result was desirable and necessary, under Section 122(d)(6) such a Rule would have been meaningless.

In the first place, the taxable year would have been a *loss* year. Therefore, the cash basis taxpayer could have had *no* excess profits tax *liability* in the taxable year. But this would not have placed the cash basis taxpayer at a disadvantage for the accrual basis taxpayer likewise would have had no "accrued" tax liability in a loss year. These facts explain the absence of Rule (A) as unnecessary. They also warrant another conclusion.

When Congress left out Rule (A) it must have done so on the basis of the foregoing analysis. That analysis, of course, implicitly recognized that where the *taxable* year was a *loss* year, neither a cash nor an accrual basis taxpayer ordinarily could "accrue" an excess profits tax "*within the taxable year*". Nor would a tax be paid in the year imposed.

It is apparent, therefore, that neither "paid" nor "accrued" used in Section 122(d)(6) could have been intended to refer to methods of accounting. "Paid or

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[58] "A desire for equality among taxpayers is to be attributed to Congress rather than the reverse." *Colgate-Palmolive-Peet Co.* v. *U.S.* (1943) 320 U. S. 422, 425.

accrued" in such a context would have been as inapposite as Rule (A). These terms must have referred of necessity to taxes of *prior* years[59] which were discharged by payment (paid) or which arose (accrued) in the taxable (loss) year. These are "transactional" meanings not "accounting methods" ones for these results would have been the same regardless of accounting methods.

The other omission occurred for the same reason and warrants the same conclusion. Section 105(e) of the Revenue Act of 1942 was captioned, "Technical Amend-

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[59] There is an earlier example of this type of construction. Under the 1936 Revenue Act personal holding companies were allowed deductions in computing adjusted net income of "not only ordinary Federal income and profits tax paid during the taxable year but also the special tax under Section 102." (H.R. No. 1546, 75th Cong., 1st Sess., p. 711-2. See S. R. No. 1242, same session) Thus, where a company paid during a current year, Section 102 taxes assessed for prior years, a benefit was gained, the Report explained. But Congress had not intended that Section 102 surtaxes should be paid out of current earnings. It had been intended that they should have been paid out of accumulations. Therefore, it was proposed that the 1937 Revenue Act amend Section 351 (of the 1936 Revenue Act) by making the Section 102 taxes specifically non-deductible

Of significance is the fact that the amendment was made, not because of any question of accounting methods, but rather on the basis of Congressional policy as to Section 102. But more important is the fact that while Section 48(c) (defining paid or accrued to mean accounting methods) appeared in the 1936 Revenue Act as well as the 1937 Revenue Act it was flatly stated that taxes "paid during the taxable year" were deductible with no reference to accounting methods. While the amendment affected Section 102, no attempt was made to change the provisions allowing deductions for income and profits taxes "paid or accrued".

ments[60] Made Necessary By Change in Base for Corporate Tax." Section 105(e)(3) added Section 122(d)(6) to the Code. Sections 105(e)(1) and (2) related, respectively, to the credit for dividends received and to the computation of Section 102 net income. These two subparagraphs contained specific references to the newly added Section 26(e) credit (amount subject to excess profits tax). In each case, that credit was allowed as a reduction. But no reference to the Section 26(e) credit appeared in Section 105(e)(3) of the 1942 Revenue Act relating to Section 122(a) and (d)(6)—although Section 122(c) was amended by that Act to require a normal tax net income computation "without" such credit.

The reason is obvious. As there could be no excess profits net income in a loss year by definition[61] the 26(e) credit would always be naught in such a context. For the same reason, no excess profits tax liability could arise to be "accrued" in a loss year. Taxes were not paid in the

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[60] The Government makes an argument based upon the phrase "technical amendments", the substance of which is that there was something mutually exclusive in the concept of "technical amendments" on the one hand and a significant change in the law on the other. Assuming but not conceding that Section 122(d)(6) was a significant change, the basis of the Government's argument is not correct. The two subsections of Section 105(e) of the Revenue Act of 1942 immediately preceding subsection (3), which added the operating loss provisions here in issue, deal respectively with the credit for dividends received and computation of Section 102 net income. It can scarcely be considered that these provisions are any less significant than those relating to the occasional impact of a net operating loss. Moreover, other legislation bearing the caption of "technical" has dealt with more than narrow technical matters. See as a recent illustration the Technical Changes Act of 1953, 67 Stat. 615.

[61] See footnote 38, *supra*.

year imposed but in the subsequent year and none would be "imposed" in a loss year. It must be concluded, therefore, that the absence of the Section 26(e) credit in Section 122(a) or (d)(6) meant that the excess profits tax "paid or accrued" could not have referred to the tax *for* the loss year but must have related to the tax of a prior year. That being so, "paid or accrued" must have been used in a transactional sense.

2. The purpose of the Section 122(d) adjustments and (d)(6) in particular was to help convert net loss into economic loss. The frame of reference for this problem must take cognizance of the fact that the Revenue Act of 1942 amended the excess profits tax law so as to make the rates high enough to be confiscatory in nature.[62] It is not surprising therefore that Congress, to alleviate some hardship in such circumstances, liberalized certain pre-existing relief provisions[63] and enacted new ones.[64]. Among

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[62] The Congressional intention was stated to be a "desire that the rearmament program should furnish no opportunity for the creation of new war millionaires or the further substantial enrichment of already wealthy persons." The provisions were applicable to all corporations whether or not directly engaged in the defense program. This Act increased the tax rates from a graduated scale ranging from 35 to 60 percent to a 90 percent rate, however, with an over-all limitation of 80 percent subject to a postwar credit of 10 percent. Compare H. R. No. 2894, 76th Cong., 3d Sess., p. 2.

[63] "The 1942 Act amendments substantially broadened the relief provisions, increasing their elasticity." See *7A Mertens, Law of Federal Income Taxation*, (1943 Ed.) 18. One illustration bearing a close analogy to the provisions here in question was the allowance of a two-year carry-back of unused excess profits credits under Section 710(c)(3)(A). That provision was added by Section 204(b) of the Revenue Act of 1942 and was made retroactive to 1941.

[64] Perhaps the most important was Section 710(a)(1)(B) permitting an alternative computation of excess profits tax liability based upon 80 percent of corporation surtax net income less income tax liability.

the existing relief provisions which were expanded were those relating to net operating losses here involved.[65]

It is clear that Congress intended all six adjustments under Section 122(d) to have the effect of sterilizing net income or net loss as the case might be of all non-economic factors. Stated otherwise, the purpose was to convert net loss (excess of deductions over gross income) into economic loss[66] called "net operating loss".

Where a taxpayer "paid" an excess profits tax that transaction had an operational aspect and parting with cash was certainly an economic loss. By the same token the coming-into-existence of an excess profits tax liability by settlement of a dispute, for example, met the same tests.

As already indicated, the adjustments under Section 122(d) were variously referred to by subsections (a), (b), and (c). It follows, therefore, that the Congress not only provided that a net operating loss as defined should be sterilized of all non-economic loss elements but it applied the same concept in the computation of the amount of the net operating loss carry-backs and carry-overs, as well as in the computation of the amount of the net operating loss deduction itself. In the latter situations net income (not net loss) was converted into economic net income. Thus, even though the net operating loss *deduction* as finally determined under Section 122(c) was allowed as a deduction in computing net income by Section 23(s), it is inaccurate to describe and imply, as the Government does, that the adjustment provided by Section 122(d)(6) was a conventional deduction and *directly* involved in computing net income.

A number of convolutions were involved in going from the payment of an excess profits tax in a loss year to the

[65] Significantly, the 1942 Revenue Act for the first time since the 1918 Revenue Act permitted a two-year carry-*back* of a net operating loss. See Section 122(b)(1).

[66] See House Ways and Means Committee Report No. 855, 76th Cong., 1st Sess., p. 17.

allowance of a deduction for a net operating loss in a prior year. During the course thereof it was quite possible that the (d)(6) adjustment could have been offset, consumed or otherwise altered so as to give no direct benefit as a deduction. The somewhat complicated computations required by Sections 122(b) and (c) in particular suggest a remote rather than a direct relationship.

More important, the amount of the net operating loss *deduction* depended primarily upon the amount of net operating loss carry-overs and carry-backs from *other years*. Necessarily, therefore, the deduction itself was not controlled by Sections 43 or 48(c) of the Code, for the deduction obviously was neither paid nor accrued *in* the year the deduction was sought. Only in the years where the net operating *losses* were incurred could the "paid or accrued" question really arise, and in those years, as already indicated, Section 48(c) does not apply.

Summarizing Argument II thus far, it has been established that:

The (d)(6) adjustment, enacted by Congress in an era of high taxes but in a spirit of tax relief, tended to benefit taxpayers who incurred losses. The adjustment itself was not a conventional deduction but involved treating an excess profits tax either paid or accrued "as if" it were a deduction. This adjustment, coming as it did after the prior determination of net income (or net loss) was not controlled by Section 48(c) and served to produce a new statutory concept, economic loss, which was typical of a number of similar concepts frequently used by the Congress.

Congress did not expressly define "paid or accrued" when used in Section 122(d)(6). It did, nevertheless, devote considerable attention and statutory language to the problems related to and created by Section 122(d)(6) which indicates the Congressional intent in this respect. The most significant deduction warranted is that Congress was

not referring to taxes of the loss year itself when using the language "taxes paid or accrued within the taxable year." That this would have been an anomaly was indicated by the deliberate omission of both Rule (A) and the Section 26(e) credit from Section 122(d)(6). Because the taxes referred to as "paid or accrued" could not have related to the taxable year itself, they must have related to a prior taxable year. That being so, the only plausible meaning of the words would be in the transactional sense, the accounting method sense being inapposite.

Ironically, every attack which the Government makes on the taxpayer's position would, if valid, apply with equal force where a cash basis taxpayer paid an excess profits tax in a loss year. Yet the necessary logic of the Government's accounting method argument is that a cash basis taxpayer should benefit in such a situation. Such an inconsistent and untenable position suggests that the Government's real argument is that it does not agree with the Congress and, therefore, Section 122(d)(6) should not apply.

D. Even if it be held that "paid or accrued" literally referred to methods of accounting described in Section 48(c) when used in Section 122(d)(6), this Court may construe the quoted words to refer to transactions rather than accounting methods, if the former was the purpose even though not the literal meaning of the provision.

The supremacy of purpose over language was stated in *U. S. v. American Trucking Associations*, (1940) 310 U. S. 534, 543. Where words have a perfectly plain meaning that should be followed; however, where that meaning has led to absurd or futile results, this Court has looked beyond the words to the purposes of the act. This has been done even where the plain meaning did not produce absurd results but merely unreasonable ones which were, however, plainly at variance with the policy of the legislation

as a whole.[67] As previously pointed out, the Government's argument produces gross inequities which are far beyond mere "unreasonable" results. Moreover, the taxpayer has demonstrated that the purpose of the legislation was to grant relief to taxpayers incurring losses by permitting excess profits tax paid in the loss year to be treated as a deduction in converting to economic loss. This was the purpose. If the result is otherwise because of literal meaning, then the purpose has not prevailed.

III.

The Fortuitous Occurrence of a Net Operating Loss in 1947 Which Produced a Net Operating Loss Deduction for 1945 and Hence Resulted in a Refund or Credit of That Year's Taxes Including the Excess Profits Tax Paid in 1946 Does Not, as a Matter of Law, Prevent the Deduction of Excess Profits Tax Paid in the Year 1946.

It was a sad fact that the taxpayer incurred a net operating loss in 1947 as well as in 1946. This fortuitous and unpleasant occurrence produced a net operating loss carryback from 1947 to 1945 where, after conversion into a net operating loss deduction, the 1945 excess profits tax liability was eliminated. The result was that refunds or credits were made to the taxpayer in 1947 and 1948[68] of the excess profits taxes for 1945 which had been paid in 1946. The Government concludes, therefore, that the taxpayer suffered no economic loss in 1946 by virtue of payment in 1946 of the 1945 excess profits tax liability.

Emphasizing the word "imposed" in Section 122(d)(6), the Government argues that because the excess profits taxes

[67] See also *Helvering* v. *Morgan's Inc.* (1934) 293 U. S. 121, 125; *Markham* v. *Cabell* (1945) 326 U. S. 404 at 409; *Farmers' Reservoir & Irrigation Co.* v. *McComb* (1949) 337 U. S. 755 at 764 and *Takao Ozawa* v. *U. S.* (1922) 260 U. S. 178 at 194.

[68] R. 10.

were subsequently refunded they did not represent an amount of tax actually imposd; only one excess profits tax was imposed for 1945 and that was the amount which was *finally* determined after application of the 1947 carry-back. The Government then cites some language out of context from the companion case of *Lewyt Corporation* in the Second Circuit Opinion and refers to a brief to be filed in Docket No. 417, the *Lewyt Corporation* case before this Court on certiorari. The same argument was raised by the Government in the proceeding below but was not even adverted to by the Court of Claims in either of two majority opinions or two dissenting opinions.

The taxpayer's position is that the payment of excess profits taxes in 1946 was, in a very real sense, an economic loss as the taxpayer was thereupon deprived of the use of $263,272.80.[69] The fact that the taxpayer recovered this amount by credit or payment several years later cannot obscure the fact that the taxpayer did suffer an economic loss by payment in the year 1946. That tax had been "imposed"; it had accrued in 1945 and had been paid in 1946.

A contrary view would be incompatible with this Court's opinion in *Manning* v. *Seeley Tube & Box Co., supra.* The "deficiency" referred to in that case, as computed under Section 271 of the Code, meant the amount "by which the *tax imposed*" exceeded the tax shown on the return. Necessarily, therefore, that opinion holds that a tax originally due for a taxable year was imposed even though a subse-

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[69] There is a reverse analogy between this situation and that in *Manning* v. *Seeley Tube and Box Co.* (1950) 338 U. S. 561. In that case this Court regarded as significant the fact that a taxpayer had retained the use of tax funds which rightfully should have been in the possession of the United States. The Government was properly entitled to have and to use the mony owed to it during the period it was owed. Thus, interest on the tax deficiency was properly payable regardless of later elimination of such a deficiency by a subsequently incurred net operating loss.

quent net operating loss carry-back might eliminate tax liability for that year.[70]

Section 56(a) of the Code required a taxpayer to pay "the tax imposed by this Chapter" in the year following the taxable year. Necessarily, that tax "imposed" must have been prior to any net operating loss carry-back as no carry-*back* could have existed at such a time. Moreover, Section 122(d)(6) speaks of a tax imposed "paid or accrued *within* the taxable year" and not to events in a subsequent taxable year. The Government reads the quoted phrase as though it referred to taxes "finally imposed for

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[70] With respect to this matter this Court stated at 566 and 567:

"The enactment of the carry-back provision in 1942 did not change this policy of the statute requiring prompt payment. This section was intended to afford taxpayers an opportunity to present for tax purposes a realistic, balanced picture of their profits and losses. It permits a taxpayer to add a net operating loss for one year to the deductions for the two previous taxable years. The Report of the Senate Committee on Finance states that the purpose of the section was to afford relief to cases where maintenance and upkeep expenses were deferred to peacetime years because of wartime restrictions. S. Rep. No. 1631, 77th Cong., 2d Sess., 51-52 (1942). But there is no indication that Congress intended to encourage taxpayers to cease prompt payment of taxes. The same Report, explaining the operation of the section which became the present carry-back provision, states, 'A taxpayer entitled to a carry-back of a net operating loss or an unused excess profits credit . . . will not be able to determine the deduction on account of such carry-back until the close of the future taxable year in which he sustains the net operating loss or has the unused excess profits credit. *He must therefore file his return and pay his tax without regard to such deduction*, and must file his claim for refund at the close of the succeeding taxable year when he is able to determine the amount of such carry-back.' S. Rep. No. 1631 at 123-124. (Italics added) We can imagine no clearer indication of a Congressional understanding and intent that the carry-back was not to be interpreted as deferring or delaying the prompt payment of taxes properly due."

the taxable year". Since subsequent events may not be taken into account in determining payment or accrual,[71] the only tax imposed, which was paid or accrued within the taxable year 1946, was the tax *paid* in 1946, no tax liability having arisen with respect to the year 1946.

It does seem apparent, however, that the word "imposed" should not necessarily have been confined either to the initial or the ultimate tax liability; it had an ambulatory meaning appropriate in either case. As used here it was only descriptive of a statutory liability for tax and not designed as a limitation.

The Commissioner of Internal Revenue apparently regards the word in the same light as does the taxpayer and in a similar context. A recent ruling relating to Section 102(d)(1)(A) of the Code, which permitted a deduction from "Section 102 net income" for "income, war profits, and excess profits taxes * * * paid or accrued during the taxable year * * * but not including the tax imposed by this section * * *," held that even though such taxes were ultimately refunded as a result of a subsequent net operating loss carry-back, nevertheless the above deduction was to be determined without regard to such carry-back.[72]

The effect of the Government's argument is to nullify the annual accounting concept embedded in the tax system for many years.[73] The Government here reads the word

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[71] *Security Flour Mills Co.* v. *Commissioner* (1944) 321 U. S. 281 at 285 and 286; *Stanard-Tilton Milling Co.* (1944) 3 T.C. 1026 at 1029 and 1030, Acq., 1944-1 Cum. Bull. 3.

[72] Rev. Rul. 6, 1953-1 Cum. Bull., 120; see also Rev. Rul. 55-28, Int. Rev. Bull. No. 3, January 17, 1955, p. 65.

[73] This Court stated in *Edwin E. Healy* v. *Commissioner* (1953) 345 U. S. 278 at 284:

> "Congress has enacted an annual accounting system under which income is counted up at the end of each year. It would be disruptive of an orderly collection of the revenue to rule that the counting must be done over again to reflect events occurring after the year for which the count is made, and would

"imposed" as though it had some magic significance. The term has not been specifically defined in any statute so far as the taxpayer can determine. However, some indication of the Congressional understanding of the meaning of that word appears in the language of the House Ways and Means Committee Report filed in connection with the Revenue Code of 1954 which stated:[74]

> "The use of the word 'imposed' rather than 'levied, collected, and paid' is only a modernization of language."

CONCLUSION

For the reasons above-stated, the judgment of the Court of Claims should be affirmed.

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March, 1955.

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violate the spirit of the annual accounting system. This basic principle cannot be changed simply because it is of advantage to a taxpayer or to the government in a particular case that a different rule be followed."

While it is true that net operating loss carry-back provisions are in themselves something of a modification of the annual accounting concept, this is not to concede tha a simple paymen of tax occurring in a loss year is anything but an economic loss. The effect of the Government's argument is to admit that a payment in 1946 was an economic loss at that time but to deny that it was an economic loss in 1948.

[74] H. R. No. 1337, p. A9, accompanying H. R. 8300. (83 Cong., 2nd Sess.)

APPENDIX A

INTERNAL REVENUE CODE OF 1939*

* The Code provisions cited are those which were in effect in 1944 or 1946 as the case might be as last amended.

"SEC. 13. NORMAL TAX ON CORPORATIONS.

"(a) Definitions.—For the purposes of this chapter—

* * * * *

"(2) NORMAL-TAX NET INCOME.—The term 'normal-tax net income' means the adjusted net income minus the credit for income subject to the tax imposed by subchapter E of Chapter 2 provided in section 26(e) and minus the credit for dividends received provided in section 26(b)."

(As amended by Section 105 (a)(1) of the Revenue Act of 1942, c. 619, 56 Stat. 798.)

* * * * *

"SEC. 15. SURTAX ON CORPORATIONS.

"(a) CORPORATION SURTAX NET INCOME.—For the purposes of this chapter, the term 'corporation surtax net income' means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e) and minus the credit for dividends received provided in section 26(b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus, in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26(h). For the purposes of this subsection dividends received on the preferred stock of a public utility shall be disregarded in computing the credit for dividends received provided in section 26(b)."

(As amended by Section 105 (b) of the Revenue Act of 1942, *supra.*)

* * * * *

NOTE: Code Sections can be found in Volume 26 U.S.C., 1952 ed., at corresponding section numbers.

"SEC. 21. NET INCOME.

"(a) DEFINITION.—'Net income' means the gross income computed under section 22, less the deductions allowed by section 23.

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"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

* * * * * *

"(c) TAXES GENERALLY.—

"(1) ALLOWANCE IN GENERAL.—Taxes paid or accrued within the taxable year, except—

* * * * * *

"(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, or section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

(As amended by Section 105 (c) (1) of the Revenue Act of 1942, *supra.*)

* * * * * *

"(s) NET OPERATING LOSS DEDUCTION.—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * * *

"SEC. 26. CREDITS OF CORPORATIONS.

* * * * * *

"(c) Net Operating Loss of Preceding Year.—

"(1) Amount of Credit.—The amount of net operating loss (as defined in paragraph (2)) of the corporation for the preceding taxable year (if beginning after December 31, 1937) but not in excess of (A) the section 102 net income for the taxable year, in the case of the tax imposed by section 102; (B) the Supplement P net income for the taxable year, in the case of the computations required under Supplement P; or (C) the Sub-

chapter A net income for the taxable year, in the case of the tax imposed under Subchapter A.

"(2) Definition.—As used in this section the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the following exceptions and limitations—

"(A) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under Section 114 (b) (2), (3), or (4);

"(B) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations.

"(C) For the purposes of this paragraph, the net operating loss deduction provided in section 122 shall not be allowed.

In the case of a taxable year beginning after December 31, 1937, and before January 1, 1939, the term 'net operating loss' means net operating loss as defined in section 26 (c) of the Revenue Act of 1938, 52 Stat. 467."

(As amended by Section 132 (a) of the Revenue Act of 1942, *supra.*)

* * * * * *

"(e) Income Subject to Excess-Profits Tax.—In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b)). In the case of any corporation computing such tax under section 721 (relating to abnormalities in income in the taxable period), section 726 (relating to corporations completing contracts under the Merchant Marine Act of 1936), section 731 (relating to corporations engaged in mining strategic minerals), or section 736 (b) (relating to corporations with income from long-term contracts), the credit shall be the amount of which the tax imposed by such subchapter is 95 per centum. For the purpose of the preceding sentence the

term 'tax imposed by Subchapter E of Chapter 2' means the tax computed without regard to the limitation provided in section 710 (a) (1) (B) (the 80 per centum limitation), without regard to the credit provided in section 729 (c) and (d) for foreign taxes paid, and without regard to the adjustments provided in section 734. This subsection shall not apply to any corporation exempt from such tax under section 725 or section 727."

(Code section 26 (e) was added by Section 105 (d) of the Revenue Act of 1942; it was repealed by Sec. 122 (g) (1), 1945 Act, effective for taxable years beginning after December 31, 1945)

"SEC. 41. GENERAL RULE.

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

"For use of inventories, see section 22 (c)."

"SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

"The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the accrual method of accounting, amounts (except amounts includible in computing a partner's net income under section 182) accrued as deductions and credits only by reason of the

death of the taxpayer shall not be allowed in computing net income for the period in which falls the date of the taxpayer's death."

(As amended by Section 134 (b) of the Revenue Act of 1942, *supra*.)

* * * * * *

"SEC. 48. DEFINITIONS.

"When used in this chapter—

* * * * * *

"(c) 'PAID OR INCURRED', 'PAID OR ACCRUED'.—The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part."

* * * * * *

"SECTION 56. PAYMENT OF TAX.

"(a) TIME OF PAYMENT.—The total amount of tax imposed by this chapter shall be paid on the fifteenth day of March following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the fiscal year."

"(b) INSTALLMENT PAYMENTS.—Except in the case of an individual (other than an estate or trust and other than a nonresident alien with respect to whose wages, as defined in Section 1621 (a), withholding under Subchapter D of Chapter 9 is not made applicable), the taxpayer may elect to pay the tax in four equal installments, in which case the first installment shall be paid on the date prescribed for the payment of the tax by the taxpayer, the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth monh, after such date. If any installment is not paid on or before the date fixed for its payment, the whole amount of the tax unpaid shall be paid upon notice and demand from the collector."

* * * * * *

(As amended by Section 5 (d) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.)

"SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

* * * * * *

"(d) DEFINITIONS.—As used in this chapter—

"(1) SECTION 102 NET INCOME.—The term 'section 102 net income' means the net income, computed without the benefit of the capital loss carry-over provided in section 117(e) from a taxable year which begins after December 31, 1940, and computed without the net operating loss deduction provided in section 23 (s), minus the sum of—

"(A) Taxes.—Federal income, war-profits, and excess-profits taxes (other than the tax imposed by Subchapter E of Chapter 2 for a taxable year beginning after December 31, 1940), paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

* * * * * *

. (As amended by Section 138 of the Revenue Act of 1942, *supra.*)

"(D) Income subject to excess profits tax.—The credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e)."

(As amended by Sec. 105 (e) (2) of the Revenue Act of 1942, *supra.*)

"SEC. 122. NET OPERATING LOSS DEDUCTION.

"(a) DEFINITION OF NET OPERATING LOSS.—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(As amended by Section 105 (e) (3) (A) of the Revenue Act of 1942, *supra.*)

"(b) AMOUNT OF CARRY-BACK AND CARRY-OVER.—

"(1) NET OPERATING LOSS CARRY-BACK.—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each

of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4) and (6), and (B) by determining the net operating loss deduction for such second preceding taxable years without regard to such net operating loss."

(As amended by Section 153 (a) of the Revenue Act of 1942, *supra.*)

* * * * * *

"(c) AMOUNT OF NET OPERATING LOSS DEDUCTION.—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d), (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation the normal-tax net income (computed without such deduction and without the credit provided in section 26 (e);

(As amended by Sections 105 (e) (3) (B) and 153 (b) of the Revenue Act of 1942, *supra.*)

"(d) EXCEPTIONS, ADDITIONS, AND LIMITATIONS.—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

"(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b), (2), (3), or (4);

"(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

"(3) No net operating loss deduction shall be allowed;

"(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains.

"(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules —

"(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

"(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

(As amended by Sections 105 (e) (3) (C) and 150 (e) of the Revenue Act of 1942. Section 304 (e) of the Excess Profit Tax Act of 1950 made Code Sec. 122 (d) (6) inapplicable with respect to any taxable year ending after June 30, 1950.)

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"SEC. 271. DEFINITION OF DEFICIENCY.

"(a) IN GENERAL.—As used in this chapter in respect of a tax imposed by this chapter, 'deficiency' means the amount by which the tax imposed by this chapter exceeds the excess of—

"(1) The sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

"(2) the amount of rebates, as defined in subsection (b) (2), made."

(As amended by Section 14 (a) of the Individual Income Tax Act of 1944.)

"SEC. 336. SUPPLEMENT P NET INCOME.

"For the purposes of this chapter the term 'Supplement P net income' means the net income with the following adjustments:

"(a) ADDITIONAL DEDUCTIONS.—There shall be allowed as deductions—

"(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

• • • • • •

(As amended by section 3 (b) of Public Law 378, 81st Congress.)

"SEC. 505. SUBCHAPTER A NET INCOME.

"For the purposes of this subchapter the term 'Subchapter A Net Income' means the net income with the following adjustments:

"(a) ADDITIONAL DEDUCTIONS.—There shall be allowed as deductions.—

"(1) Federal income, war-profits, and excess-profits

extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

• • • • • •

"SEC. 507. MEANING OF TERMS USED.

"(a) GENERAL RULE.—The terms used in this subchapter shall have the same meaning as when used in chapter 1.

• • • • • •

"SEC. 710. IMPOSITION OF TAX.

[As added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974.]

"(a) Imposition.—

(As amended by Sec. 201 of the Revenue Act of 1941.)

"(1) General Rule.—There shall be levied, collected and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(As amended by Sec. 202 of the Revenue Act of 1942.)

"(A) 95 per centum of the adjusted excess profits net income, or

(As amended by Sec. 202 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21.)

"(B) an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter), and without regard to 80 per centum of the credit provided in section 26 (h) (relating to credit for dividends paid on certain preferred stock.

(As amended by Sec. 202 (b) of the Revenue Act of 1943.)

• • • • • •

"(b) Definition of Adjusted Excess Profits Net Income. As used in this section, the term 'adjusted excess profits net income' in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

"(1) Specific exemption.—A specific exemption of $10,000, * * *

(As amended by Sec. 204 of the Revenue Act of 1943.)

"(2) Excess profits credit.—The amount of the excess profits credit allowed under section 712; and

"(3) Unused excess profits credit.—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

(As amended by Sec. 2 (a) of the Excess-Profits Tax Amendments of 1941, c. 10, 55 Stat. 17 and Sec. 204 (a) of the Revenue Act of 1942.)

"SEC. 711. EXCESS PROFITS NET INCOME.

(As added by Sec. 201 of the Second Revenue Act of 1940.)

"(a) Taxable Years Beginning After December 31, 1939.—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be as follows:

"(1) Excess profits credit computed under income credit.—If the excess profits credit is computed under section 713 the adjustments shall be as follows:

"(A) INCOME SUBJECT TO EXCESS PROFITS TAX.—In computing such normal-tax net income the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter) shall not be allowed;

(As amended by Sec. 206 (a) (1) of the Revenue Act of 1942.)

* * * * * * *

"(J) Net Operating Loss Deduction Adjustment.—The net operating loss deduction shall be adjusted as follows:

"(i) In computing the net operating loss for any taxable year under section 122 (a) and the net income

for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; * * *

"(ii) In lieu of the reduction provided in section 122 (c) such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations specified in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (B), without regard to any credit for dividends received, and without regard to any credit for interest received provided in section 26 (a) exceeds the excess profits net income (computed without the net operating loss deduction).

(As amended by Sec. 210 (a) of the Revenue Act of 1942.)

"(2) Excess profits credit computed under invested capital credit.—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * * *

"(L) Net Operating Loss Deduction Adjustment.—The net operating loss deduction shall be adjusted as follows:

"(i) In computing the net operating loss for any taxable year under section 122 (a), and the net income for any taxable year under section 122 (b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under subparagraph (B) of this paragraph for such taxable year; and

"(ii) In lieu of the reduction provided in section 122 (c), such reduction shall be in the amount by which the excess profits net income computed with the exceptions and limitations provided in section 122 (d) (1), (2), (3), and (4) and computed without regard to subparagraph (D), without regard to any credit for dividends received, and without regard to

any credit for interest received provided in section 26 (a) exceeds the excess profits net income (computed without the net operating loss deduction).

(As amended by Sec. 210 (b) of the Revenue Act of 1942.)

PRIOR INTERNAL REVENUE CODE PROVISIONS

"SEC. 23 (c). TAXES GENERALLY.—Taxes paid or accrued within the taxable year, except—

"(1) Federal income, war-profits, and excess-profits taxes (other than the excess-profits tax imposed by section 106 of the Revenue Act of 1935 (49 Stat. 1019), or by section 602 of the Revenue Act of 1938 (52 Stat. 567), and other than the declared value excess-profits tax imposed by section 600);"

(As amended by Section 506 (b) of the Second Revenue Act of 1940, c. 757, 54 Stat. 974.)

REVENUE ACT OF 1937 [c. 815, 50 Stat. 813]

"TITLE IA—ADDITIONAL INCOME TAXES

"SEC. 356. ADJUSTED NET INCOME.

"For the purposes of this title the term 'adjusted net income' means the net income with the following adjustments:

"(a) Additional Deductions.—There shall be allowed as deductions—

"(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent now allowed as a deduction under section 23; but not including the tax imposed by section 102, section 351 (either before or after its amendment by the Revenue Act of 1937), or a section of a prior income tax law corresponding to either of such sections.

• • • • • •

"SEC. 357. MEANING OF TERMS USED.

"The terms used in this title shall have the same meaning as when used in Title I."

"TITLE II—FOREIGN PERSONAL HOLDING COMPANIES

"SEC. 336. SUPPLEMENT P NET INCOME.

"For the purposes of this title the term 'Supplement P net income' means the net income with the following adjustments:

"(a) Additional Deductions.—There shall be allowed as deductions—

"(1) Federal income, war-profits, and excess profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 351 (either before or after its amendment by the Revenue Act of 1937), or a section of a prior income-tax law corresponding to either of such sections."

* * * * * *